91-1470

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER, 1992, TERM

JOE E. FRYAR,

PETITIONER

VERSUS

EDWARD C. ABELL, JR., AND
CAREY WALTON, ET AL,
RESPONDENTS.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI
VOLUME I

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QUESTIONS PRESENTED

This petition for writ of certiorari on behalf of defendant-relator **JOE E. FRYAR** (petitioner) presents the following legal questions arising from a civil action lately pending before the United States Court of Appeals for the Fifth Circuit (the Fifth Circuit):

(1) Whether the RICO statute, 18 U.S.C. § 1961, et seq., specifically 18 U.S.C. § 1961(5), is unconstitutionally vague as applied to petitioner's specific conduct;

(2) Whether the post-trial application of the "relatedness" and "continuity" elements of RICO's pattern requirement to petitioner's conduct constitutes an impermissible retroactive application of a substantive change in the law as interpreted by the Fifth Circuit, thereby denying to petitioner his right to due process under the Fifth

Amendment to the United States Constitution; and

(3) Whether the denial of the right to present evidence and argument to the jury on the issues of the relatedness and continuity aspects of the pattern requirement and the lack of a specific finding of the jury on those issues constitutes an impermissible infringement on petitioner's right to trial by jury under the Seventh Amendment to the United States Constitution.

PARTIES TO THE PROCEEDING

The parties to the proceeding in the Fifth Circuit whose judgment is sought to be reviewed were:

Joe E. Fryar, Petitioner
Alexandria, Louisiana

Wright, Lindsey & Jennings,
Respondent
Little Rock, Arkansas

Valley Forge Insurance Company,
Respondent
Chicago, Illinois

Edward C. Abell, Jr., Respondent and
class representative
Lafayette, Louisiana

Carey Walton, Respondent and
class representative
Opelousas, Louisiana

All bondholders of Westside Habilitation Center bonds, which are members of class of plaintiffs,
Respondents

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No. _____

In The

Supreme Court of the United States

October Term, 1992

JOE E. FRYAR,

Petitioner

versus

EDWARD C. ABELL, JR.,
and CAREY WALTON, et al,

Respondents

TO THE HONORABLES, THE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE UNITED STATES SUPREME COURT:

OPINION BELOW

After a two-month trial, a jury returned a multi-million dollar verdict against petitioner Fryar and others based on respondents' claims of securities fraud, racketeering and pendent state law

claims.[1] The United States District Court for the Western District of Louisiana entered judgment upon the jury verdict, awarding respondents damages totalling approximately **FIFTEEN MILLION AND NO/100 ($15,000,000.00) DOLLARS.**[2] The United States Court of Appeals for the Fifth Circuit affirmed in part and reversed in part, and remanded the case for further proceedings consistent with its opinion. See **Abell v. Potomac Insurance Company**, 858 F.2d 1104 (5th Cir. 1988).[3] Petitioner then petitioned for certiorari. This court granted certiorari, vacated judgment and

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[1] See the jury's interrogatory verdict, which is found at Appendix pp. 48 through 63.

[2] See the district court's judgment, which is found at Appendix pp. 64 through 70.

[3] See copy of the Fifth Circuit's opinion, which is found at Appendix pp. 71 through 278.

remanded. See **Fryar v. Abell**, 492 U.S. 914, 109 S. Ct. 3236, 106 L. Ed. 2d 584 (1989).[4] The Court of Appeals remanded to the district court. See **Abell v. Potomac Insurance Company**, 884 F.2d 196 (5th Cir. 1989). The district court reinstated the jury's RICO verdict and reduced the award of attorneys' fees.[5] Petitioner appealed on various grounds, including: (1) that the provisions of RICO, in particular 18 U.S.C. § 1961(5), are unconstitutionally vague in violation of the procedural due process guarantees of the 5th Amendment to the U.S. Constitution; and (2) that the uncontested facts in this case do not

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[4] See copy of this court's opinion, which is found at Appendix p. 279.

[5] See copy of the district court's ruling, which is found at Appendix pp. 280 through 291, and its judgment, which is found at Appendix 292 through 295.

constitute proof of "a pattern of racketeering activity" in light of this court's holding in **H.J. Inc. v. Northwestern Bell Tel. Co.**, 492 U.S. 229, 109 S. Ct. 2893, 106 L. Ed. 2d 195 (1989). The Fifth Circuit affirmed. See **Abell v. Potomac Ins. Co. of Illinois**, 946 F.2d 1160 (5th Cir. 1991).[6] Petitioner moved for rehearing on the grounds that the decision of the Fifth Circuit (1) denies to petitioner his due process rights under the Fifth Amendment to the United States Constitution, and (2) denies to petitioner his right to trial by jury in violation of the Seventh Amendment to the United States

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[6] See copy of the Fifth Circuit's opinion, which is found at Appendix pp. 296 through 343.

Constitution. The Fifth Circuit denied rehearing on December 11, 1991.[7]

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[7] See copy of the Fifth Circuit's denial of rehearing, which is found at Appendix pp. 344 through 345.

STATEMENT OF JURISDICTIONAL GROUNDS

On November 13, 1991, the United States Court of Appeals for the Fifth Circuit affirmed the judgment of the United States District Court for the Western District of Louisiana in this matter. Rehearing was denied on December 11, 1991.

This Court has jurisdiction to review the judgment of the district court, as affirmed by the Fifth Circuit, by writ of certiorari under **28 U.S.C. § 1254(1)**, which effectuates its appellate jurisdiction granted by **U.S.C. Const. Art. III, Section 2, cls. 1 and 2.**

STATUTE AND CONSTITUTIONAL PROVISIONS INVOLVED

The pertinent statute involved is 18 U.S.C. § 1961(5), which provides:

> "As used in this chapter --
>
> * * *
>
> (5) 'pattern of racketeering activity' **requires at least two acts of racketeering activity**, one of which occurred after the effective date of this chapter and the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity; . . . ." (Emphasis added).

The pertinent constitutional provisions involved are:

U.S.C. Const., Amendment 5,, which provides, in part:

> * * * nor be deprived of life, liberty, or

> property, without due process of law; * * *

U.S.C. Const., Amendment 7, which provides:

> In suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law.

STATEMENT OF THE CASE

The day has finally come in which the constitutionality of the RICO statute is before this Honorable Court. The background facts are as follows:

On July 5, 1984, a class action was filed on behalf of the bondholders of Westside Habilitation Center, Inc. (Westside), a Louisiana nonprofit corporation with its principal place of business in Cheneyville, Louisiana. In bringing their action, respondents invoked **15 U.S.C. section 771** (Section 12 of the Securities Act of 1933), **15 U.S.C. section 78(j)(b)** (Section 10(b) of the Securities Exchange Act of 1934) and **17 C.F.R. section 240.10b-5 (1987)** (Rule 10b-5), **18 U.S.C. section 1961, et seq.** ("RICO"), **LSA-R.S. 51:701, et seq.** (the "Louisiana Blue Sky Law") and **LSA-C.C. Arts. 2315** and **2316**. Consequently, the district court had jurisdiction to hear

and decide respondents' claims by virtue of its federal question jurisdiction, and it had jurisdiction to hear and decide pendent state law claims by virtue of the doctrine of "ancillary jurisdiction".

This case had its origin in 1976, when a citizen of Alexandria, Louisiana, perceived a dire need for a facility to take care of the mentally retarded and emotionally disturbed citizens of Louisiana. This citizen approached petitioner Fryar, a duly licensed architect and Frank Lloyd Wright laureate, for help in constructing this facility. Petitioner Fryar's immediate response was that he had no interest in operating such a facility, but he would build it. Originally, petitioner Fryar was to build and own the facility, which would be leased to others who would operate it. However, shortly after this undertaking began, petitioner Fryar

abandoned the effort to construct the facility, when he was unable to secure financing at reasonable interest rates.

In August of 1978, Joseph D. Hancock, an underwriter and investment banker, proposed the creation of a nonprofit corporation to own and operate the facility, which would be funded by an offering of revenue bonds. Accordinly, on April 5, 1979, Westside was formally organized as a nonprofit corporation. As ultimately devised, Hancock's plan provided that Westside would be a "start up" facility meaning it had neither operating history nor initial source of working capital. Funds to retire its revenue bonds would be generated exclusively by Medicaid reimbursement at 100% of costs.

To qualify for such reimbursement, the facility had to first achieve 80% occupancy for a continuous period of 90

days. Because it had no threshold funds, Westside had to secure a person or entity who would assume the interim financial burden and venture risk of operating the facility until, if ever, it obtained the occupancy level entitling it to 100% reimbursement. The financial burden and risk of the interim operation of Westside was awesome. From the first day of operation, with or without occupancy, the facility had to be fully equipped and fully staffed. As such, the cost estimate to put the facility in such a "start up" posture was $175,086.00 per month, or approximately $5,000.00 a day.

Hancock had previously sought to induce petitioner Fryar into assuming the financial risk of an interim operation of the facility. Petitioner Fryar rejected this proposal, fearing that the possible profit did not justify his assumption of the risk of the venture. This did not

discourage Hancock who continued to fine-tune his ultimate plan. All this time, petitioner Fryar continually objected to Hancock's ever increasing onerous conditions, and, on July 9, 1981, in a letter to Hancock, petitioner agonized:

> "The only two items that I ever intended to agree to, were the 80% occupancy clause and, reluctantly, the $1,000,000 line of credit which could be secured by a Westside Bond, but, like a cancer, the conditions and costs to me are growing unchecked. I have no objection to life insurance and performance bond, but withholding $700,000 until the job is finished and requiring me to buy $2,000,000 in Westside bonds while everyone else collects their fees up front (which evidently I have to pay out of my pocket), is unreasonable and unfair. It would also be stupid of me to put everything that I own into one project.

* * *

> Joe, I am sick and embarrassed by this lingering sore. also, the longer it lingers, more additional onerous conditions are loaded on to me."

By this time, petitioner Fryar had already spent $324,647.00 "on the project" on promises of reimbursement by Westside, if it succeeded. In order to salvage his accrued loss, petitioner Fryar cast about for someone with whom to share his financial burden. Eventually, petitioner Fryar approached an acquaintance, Clayton Chambers, to determine if he was interested in assuming some of petitioner's obligations. In a letter of June 30, 1981, petitioner Fryar wrote to Chambers:

> "Dear Mr. Chambers:
>
> It was a real pleasure to visit with you and enjoy Bermuda hospitality.
>
> You had requested a written proposition on my Cheneyville, Louisiana

project as a possible investment for one of your clients. I am interested in selling it under the following conditions:

1. I will sell the property for $150,000.

2. I am to continue to serve as architect-developer for a fee of 10% of the cost of construction, furniture and fixtures.

3. You will buy $2,000,000 of Westside Bonds and pledge them to completion of the development by me.

4. You will pay for a $11,000,000 life insurance policy on me which will be pledged to the trustee for completion of the project.

5. You will furnish Westside with a $1,000,000 operating line of credit for the life of the Bonds, which is 30 years.

6. You will pay all expenses and receive any reimbursement for operting the facility for 90 days after it reaches and maintains 80% occupancy.

If your client is interested in this proposition please let me know and I will have my lawyer prepare the necessary documents.

Sincerely,

JOE E. FRYAR, AIA"

Chambers eventually agreed using one of his corporations All American Services Company (AA) as the primary obligor and verbalized his agreement in a handwritten letter of November 24, 1981, which read:

"Dear Joe:

I had expected to hear from you by this time in connection with the sale to All-American Services Company of the Cheneyville property, but no doubt you have this in hand.

A-A Services has been duly incorporated and hereby agrees:

1-We will buy the property for $150,000.

2-Acquire and pledge $2,000,000. of bonds to your development contract.

3-Pledge $1,000,000. of bonds to the line of credit.

4-Pay all expenses and receive all income initially.

I hope all is going well!

Sincerely

H. Clayton Chambers"

In accordance with his agreement with Chambers, petitioner Fryar sold the Cheneyville property to AA for $150,000.00. As a means of compensating AA for the assumption of petitioner Fryar's obligations, AA sold the Cheneyville property to Westside for $2,459,700.00, which transaction was a matter of public record. On receipt of this purchase price, AA purchased and pledged $2,000,000.00 of Westside Bonds, as required by the development agreement between petitioner Fryar and Westside. The remainder was retained by AA to

compensate it for the assumption of Fryar's additional obligations.

In due course, the Westside bond issue was closed. Thereafter, Bossier Bank, the indenture trustee for the offering, **imprudently invested $8,000,000 of the $13,500,000 in bond proceeds in unsecured deposits with the Penn Square Bank in Oklahoma City.** Penn Square failed shortly thereafter.

In August of 1982, because of the loss of Westside funds, construction halted and petitioner Fryar incurred costs. Construction subsequently resumed, when litigation against Bossier Bank resulted in a settlement returning the principal of the deposit but only part of the interest. However, because completion of the project was delayed, earlier referrals of patients to Westside were lost. Notwithstanding these adversities, under petitioner Fryar's

efforts the facility achieved the occupancy level needed to qualify for 100% Medicare reimbursement. At this point in time, petitioner Fryar experienced uncompensated out of pocket expenses of $780,000.00.

Because of these adversities, Westside defaulted on the bond payment scheduled to be paid on October 1, 1984. In 1985, Westside petitioned for reorganization. At that time, petitioner Fryar had an unrecovered cash loss of $474,300.00. Westside has subsequently emerged from reorganization and has rescheduled payment of the reissued bonds, which bear interest at reduced rates. Westside is obligated to cure all interest arrearages when, and if, it has sufficient revenues to do so. Since attaining 80% occupancy, Westside has never been less than 98% occupied and is on a firm financial footing.

Westside bondholders, as a class, filed the subject lawsuit against every person, and each of the underwriting concerns and law firms, connected with the creation of Westside.[8] Named as defendants were: (1) petitioner Fryar, as the architect and developer of Westside; (2) Rodney Kendrick, chairman of Westside's board of directors and its president; (3) Hancock, Joseph & Daniels, as an underwriter offering the Westside bonds for sale to the public; (4) Joseph D. Hancock, as a promoter of Westside and the president and chief operating principal of Hancock, Joseph & Daniels; (5) Swink & Company, Inc., as an underwriter offering the Westside bonds of sale to the public; (6) Wright, Lindsey & Jennings, as counsel for the

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[8] See excerpts of respondents' original complaint, which are found at Appendix pp. 346 through 354.

underwriters of the Westside bond offering; (7) William E. Skye, as counsel for Westside; (8) John W. Peck, as bond counsel in connection with the offering of Westside bonds for sale to the public; (9) Peck, Shaffer & Williams, as bond counsel in connection with the offering of Westside bonds for sale to the public; (10) ABC Insurance Company (Valley Forge Insurance Company), as the malpractice insurer of Wright, Lindsey & Jennings; (11) National Union Fire Insurance Company of Pittsburgh, Pennsylvania, as the malpractice insurer of William E. Skye; (12) Potomac Insurance Company of Illinois, as the malpractice insurer of John W. Peck and Peck, Shaffer & Williams; (13) CNA Insurance Company, as the malpractice insurer of Wright, Lindsey & Jennings; and, (14) All American Service Company, Ltd., as an associate of Fryar in the Westside

project. Respondents' claims against a number of these defendants were compromised prior to trial.

A two-month-long jury trial was held in late 1986 and early 1987. By way of special interrogatories, the jury returned a verdict in favor of plaintiffs on all claims. With regard to the claimed RICO violations, the jury answered the following questions in the affirmative with regard to petitioner:

> 8. Do you find by a preponderance of the evidence that any of the following parties [including petitioner] violated Section 1962(a) of the RICO Act?
>
> 9. Do you find by a preponderance of the evidence that any of the following parties [including petitioner] violated Section 1962(b) of the RICO Act?
>
> 10. Do you find by a preponderance of the evidence that any of the following parties [including petitioner]

> violated Section 1962(c) of the RICO Act, for conducting or participating in the conduct of the affairs of an enterprise through a pattern of racketeering activity involving mail fraud, wire fraud, or violations of the federal securities laws?

On appeal, the Fifth Circuit upheld the jury's finding against petitioner on the RICO claim, but remanded for a redetermination of damages, interest and attorneys' fees. This Court granted certiorari, vacated the judgment and remanded for reconsideration in light of its discussion of the appropriate standard for establishing a pattern of racketeering activity under RICO in **H.J. Inc. v. Northwestern Bell Telephone Co., Inc.**, 492 U.S. 229, 109 S. Ct. 2893, 106 L. Ed. 2d 195 (1989). The Fifth Circuit remanded to the district court, which upheld the jury's verdict in light of **H.J.** and rejected petitioner's argument

that RICO is unconstitutionally vague. Petitioner took an appeal whereupon the Fifth Circuit affirmed and denied rehearing. Petitioner now petitions this Honorable Court for certiorari on three grounds: (1) that RICO's requirement that a plaintiff or prosecutor prove a "pattern of racketeering activity" is unconstitutionally vague as applied to petitioner's conduct; (2) that the post-trial application of the "relatedness" and "continuity" elements of RICO's pattern requirement to petitioner's conduct constitutes an impermissible retroactive application of a substantive change in the law as interpreted by the Fifth Circuit, thus denying to petitioner his due process rights under the Fifth Amendment to the United States Constitution; and (3) that factual findings of "relatedness" and "continuity" of the alleged predicate

acts may only be made by the jury; such findings of fact by the court effectively deprives petitioner of his right to trial by jury under the Seventh Amendment to the United States Constitution.

LAW AND ARGUMENT

I. The RICO statute, 18 U.S.C. § 1961, et seq., specifically 18 U.S.C. § 1961(5), is unconstitutionally vague as applied to petitioner's specific conduct.

Long ago, this Court established that a statute violates due process of law if it "either forbids or requires the doing of an act in terms so vague that men of ordinary intelligence must necessarily guess as to its meaning and differ as to its application." **Connally v. General Construction Co.**, 259 U.S. 385, 46 S. Ct. 126, 127, 70 L. Ed. 322 (1926).

> To sustain such a challenge, the complainant must prove that the enactment is vague "not in the sense that it requires a person to conform his conduct to an imprecise but comprehensible normative standard, but rather in the sense that no standard of conduct is specified at all." **Coates v. City of Cincinnati**, 402 U.S. 611, 614, 91 S. Ct.

> 1686, 1688, 29 L. Ed. 2d 214 (1971). Such a provision simply has no core.

Smith v. Goguen, 415 U.S. 566, 578, 94 S. Ct. 1242, 1249, 39 L. Ed. 2d 605 (1974). That is precisely the problem with the RICO statute and its "pattern" requirement: there is no core. It is, rather, a black hole. Its boundaries are ill-defined. Conduct may be swept into its reach without adequate warning. The RICO statute does not "give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly." **Grayned v. City of Rockford**, 408 U.S. 104, 108-109, 92 S. Ct. 2294, 2298, 33 L. Ed. 2d 222 (1972). Nor does it "provide explicit standards for those who apply [it]" so as to avoid "arbitrary and discriminatory applications." **Id.** Relatedness and continuity should not be

applied on an I'll-know-it-when-I-see-it basis; however, without explicit guidance generated from the sweat of the Supreme Court's brow, that is precisely the tack that has been taken by the Courts of Appeals; specifically, by the Fifth Circuit in the instant case.

In 1989, this Court wisely recognized the disparate interpretations and applications of the statute when it decided **H.J. Inc.**, supra. However, the recognition of the problem and the Court's elucidation of the statement from **Sedima, S.P.R.L. v. Imrex Co.**, 473 U.S. 479, 105 S. Ct. 3275, 87 L. Ed. 2d 347 (1985), "that while two acts are necessary, they may not be sufficient," did more to frame the issue than to eradicate the problem. The Court's "hints" and "snippets" did not provide a sufficient framework on which to build a "meaningful concept of 'pattern.'" See

H.J. Inc., Scalia, J., concurring, 109 S. Ct. at 2906.

In the case now before the Court, the courts below have said to petitioner, "Although we don't know what "pattern" means, and although the Supreme Court hasn't defined what "pattern" means, a jury of ordinary laypersons has found that your conduct formed a "pattern." This is the sine qua non of arbitrary application. In truth and in fact, the jury was not called upon to make a finding that any alleged predicate acts were related.[9] Nor was there a finding of "continuity;" keeping in mind that neither concept had been defined with the necessary accuracy to avoid a vagueness challenge. The jury instructions set forth the law as it existed in the Fifth

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[9] See the jury's special interrogatories, which are found at Appendix pp. 48 through 63.

Circuit under **R.A.G.S.**, infra, and contained no parameters within which to find that a series of acts was related, nor any requirement that the alleged racketeering activities were continuous.[10]

The parameters of "relatedness" and "continuity" have not been brought into focus, exacerbating, rather than relieving, the vagueness of the statute. If, at the time of **H.J. Inc.**, four Justices of this Honorable Court "[had] no idea what the concept of a "closed period of repeated conduct" [meant]," how could petitioner have possibly known some thirteen years previously that his conduct may have fallen within the reach of the RICO statute? Further, in rejecting the "multiple schemes

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[10] See excerpt of the instructions given to the jury, which is found at Appendix pp. 355 through 356.

requirement," the Court has brought about two effects: The once murky waters of RICO are now polluted; and would-be RICO violators have been encouraged to do their deeds expeditiously.

Your petitioner's conduct has been characterized as a "scheme to defraud." Actually, he undertook a tremendous financial burden in order to make a facility for the care of mentally retarded and emotionally disturbed citizens of Louisiana a reality. However, while staunchly maintaining the legality of his activities, were one to concede for the sake of argument that such activities were illegal, they were performed within the parameters of a single "scheme." Petitioner's conduct did not pose even the slightest "threat of continuity." Once the bonds were sold, the so-called "scheme" ended. Something more is required in order to

brand a person a "racketeer." By defining RICO in terms of a "pattern" of racketeering activity, Congress intended that there be something more than multiple predicate acts. By attempting to define "pattern" in terms of "relatedness" and "continuity," this Court has indicated that there be something more than multiple predicate acts. The time has come for this Court to define "relatedness" and "continuity" in such a way that a person of ordinary intelligence would know what is required of him in order to "steer between lawful and unlawful conduct." **Village of Hoffman Est. v. Flipside, Hoffman Est.**, 455 U.S. 489, 102 S. Ct. 1186, 1993, 71 L. Ed. 2d 352 (1982). As Justice Scalia lamented in his concurrence in **H.J. Inc**:

> But what that something more is, is beyond me. As I have suggested, it is also beyond the Court. Today's opinion has added

> nothing to improve our prior guidance, which has created a kaleidoscope of circuit positions, except to clarify that RICO may in addition be violated when there is a "threat of continuity." It seems to me this increases rather than removes the vagueness.

Id. 109 S. Ct. at 2908. In order for RICO to be upheld, it must possess the degree of certainty required for criminal laws. **H.J. Inc.**, Scalia, J., concurring, at 2909; citing **FCC v. American Broadcasting Co.**, 347 U.S. 284, 296, 74 S. Ct. 593, 600-601, 98 L. Ed. 699 (1954). It does not. Congress never intended to snare within the RICO net persons such as your petitioner. He asks this Court to take the long-awaited opportunity to rid society of the intolerable infringement on the fundamental due process rights of individuals charged with violating this

clearly unconstitutional, quasi-criminal statute.

II. The post-trial application of the "relatedness" and "continuity" elements of RICO's pattern requirement to petitioner's conduct constitutes an impermissible retroactive application of a substantive change in the law, thereby denying to petitioner his right to due process.

Should the Court forego the opportunity to declare RICO unconstitutionally vague, petitioner contends that the post-trial application of the "relatedness" and "continuity" elements of RICO's pattern requirement to petitioner's conduct constitutes an impermissible retroactive application of a substantive change in the law as interpreted by the Fifth Circuit, thereby denying to petitioner his right to due process under the Fifth Amendment to the United States Constitution. At the time of petitioner's trial in late 1986 and

early 1987, the law in the Fifth Circuit, as expressed in **R.A.G.S. Couture, Inc. v. Hyatt**, 774 F.2d 1350 (5th Cir. 1985), was that two (2) related acts of mail fraud constituted a "pattern of racketeering activity," without more. The civil RICO claims against petitioner were tested according to the rule of law established in **R.A.G.S.**, supra. On remand from this Court, the courts below utilized the **H.J. Inc.** decision, which expanded the "pattern of racketeering activity" rule of law far beyond the compass of **R.A.G.S.**, as a procrustean bed, upon which the perceived body of evidence developed during petitioner's trial was placed--its limbs stretched, rather than chopped off, to force that body of evidence to fit. This was not merely a procedural change, but worked to provide substance to the concept of "pattern"

that theretofore did not exist, and had not been applied, in the Fifth Circuit.

At all times material to the civil RICO claims against petitioner, your petitioner had no warning of the **H.J. Inc.** conduct which imposed civil and criminal liability upon him; he had no warning of what conduct to avoid or to defend against. He was not informed, for example, that "[p]redicate acts extending over a few weeks or months and threatening no future criminal conduct do not satisfy this requirement. . ." **H.J. Inc.**, 109 S. Ct. at 2902. Thus, he was not given the opportunity or informed of the possibility of tailoring his conduct so as to fall within the safe harbor of this defined "pattern of racketeering activity." Nor was petitioner informed that "though the number of related predicates involved may be small and they may occur close together in time, the

racketeering acts themselves include a specific threat of repetition extending indefinitely into the future, and thus supply the requisite threat of continuity." **H.J. Inc.**, 109 S. Ct. at 2902. Had he been on notice of the multi-factors involved in the **H.J. Inc.** definition of "pattern of racketeering activity," then during his trial he would have had the opportunity to present evidence to rebut any incriminatory evidence and particularly the conclusion that "the racketeering acts themselves include a specific threat of repetition extending indefinitely into the future." Moreover, generally speaking, had petitioner been placed on notice of the conduct proscribed by **H.J. Inc.**, he could have avoided the prohibited conduct, and during trial, he could have presented evidence in defense of the claims asserted against him and thus could have

had the opportunity to exc ate himself completely from liability.

Petitioner's right to air warning" of the nature and character of the conduct proscribed "is fundamental to our concept of constitutional liberty. (citations omitted) As such, that right is protected against judicial action by the Due Process Clause of the Fifth Amendment." **Marks v. United States**, 430 U.S. 188, 97 S. Ct. 990, 51 L. Ed. 2d 260 (1977). See also **Bouie v. City of Columbia**, 378 U.S. 347, 84 S. Ct. 1697 (1964). Petitioner's rights under the Due Process Clause of the Fifth Amendment were denied to him both at the trial level, where he did not have the opportunity to defend against the multiple factors of **H.J. Inc.**, and at the appellate level, where the substantive elements of "relatedness" and

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"continuity" were retroactively applied to his conduct.

III. Petitioner was denied the right to present evidence and argument to the jury on the issues of "relatedness" and "continuity," constituting an infringement on his right to trial by jury.

No authority need be supplied for the tenet that the right to trial by an impartial jury is a fundamental concept of due process. Petitioner was denied the right to have a jury decide critical fact-specific issues involved in this case; whether the alleged predicate acts were "interrelated by distinguishing characteristics" and "not isolated events," H.J. Inc., 492 U.S. at 240, 109 S. Ct. at 2901; and whether there existed a "threat of repetition" of unlawful conduct. Id., 492 U.S. at 241, 109 S. Ct. at 2902. Factual findings made by a district judge or an appellate court are entitled to no weight; they are no

substitute for petitioner's right to a jury trial.

None of the multiple factors involved in the issue of relatedness of the alleged predicate acts was ever presented to the jury called upon to try petitioner's case. For example, none of the several factors enumerated by this Court to be considered in connection with a determination of relatedness of predicate acts, including "criminal acts that have the same or similar purposes, results, participants, victims, or methods of commission, or otherwise are interrelated by distinguishing characteristics and are not isolated events" was presented to the jury. H.J. Inc., 109 S. Ct. at 2901, analogizing to 18 U.S.C. § 3575(3).

Overriding and essential fact questions involved in the RICO claims against your petitioner, and relied upon

by the Fifth Circuit in affirming the verdict against petitioner, were never presented to the jury impaneled to try petitioner's case. The district court's reinstatement of the jury verdict, affirmed by the Fifth Circuit, constituted a usurpation of the prerogative of the jury in determining those facts. Moreover, as discussed hereinabove, petitioner did not have the opportunity to present evidence or argument to the jury to rebut the conclusion that "the racketeering acts themselves include a specific threat of repetition extending indefinitely into the future." There certainly exists the possibility that a reasonable juror could have found no threat that petitioners' actions would project into the future; or that the alleged predicate acts were merely isolated acts. Thus, petitioner has been denied his right to trial by

jury in violation of the Seventh Amendment to the United States Constitution.

CONCLUSION

1. As applied to petitioner's specific conduct, and on its face, the RICO statute is constitutionally infirm due to its vagueness. This case involves nothing more than an alleged scheme on the part of petitioner and others to achieve a single, discrete objective; i.e., to allegedly defraud the respondents by issuing bonds and using the proceeds thereof "to finance the acquisition and construction of Westside at grossly inflated prices." This alleged scheme ended when the purpose was accomplished. It was an isolated occurrence without any evidence from which a threat of ongoing illegal conduct could be inferred. Petitioner's conduct was not of the sort contemplated by Congress as racketeering activity. However, the RICO statute is so vague that a person may run afoul of the

statute in ways never intended by Congress. A person of ordinary intelligence may not know what conduct is prohibited, thus allowing for arbitrary enforcement and application of the statute to persons like petitioner. As such, the statute is unconstitutional.

2. Petitioner has been denied due process of law inasmuch as the law as interpreted by this Court in **H.J. Inc.**, supra, which represented a substantive change from the law as interpreted by the Fifth Circuit in **R.A.G.S.**, supra, was retroactively applied to the evidence adduced at trial, without petitioner having had advance notice of the requirements of the law by which his conduct would be measured. Petitioner was tried under the clear past precedent of the Fifth Circuit: that evidence of two predicate acts, without more, would

suffice to establish a "pattern" of racketeering activity. The plaintiffs did not have to prove relatedness or continuity, and petitioner was not allowed to defend himself on that basis. At the time of the complained-of activities, petitioner was not on notice of the standard that would ultimately be applied to him and, thus, was deprived of the opportunity to conform his conduct to that standard.

3. Because petitioner was deprived of the opportunity to present evidence and argument to the jury on the issues of "relatedness" and "continuity," and because the jury did not make findings on those factual issues, petitioner suffered the loss of his right to have a jury examine and adjudicate the facts of his case. At the trial, he was deprived of the opportunity to present evidence to

exculpate himself from liability. Finally, petitioner was deprived of the right to have essential questions of fact determined by an impartial jury in violation of the Seventh Amendment to the United States Constitution. The three grounds upon which this petition is based combine synergistically to more than adequately show the egregious and intolerable violations of petitioner's rights. The judgment of the Fifth Circuit should therefore be reversed.

WHEREFORE, PETITIONER RESPECTFULLY PRAYS that this petition for writ of certiorari be granted and that after due proceedings are had, this Honorable Court reverse the judgment of the United States Court of Appeals for the Fifth Circuit, which affirmed the district court's judgment holding petitioner liable to

respondents under the civil RICO statutes.

Respectfully submitted:

J. MINOS SIMON, LTD.
1408 West Pinhook Road
Post Office Box 52116
Lafayette, Louisiana 70505
Telephone: (318) 233-4625

BY: _____
J. MINOS SIMON
Bar Roll No. 12278

UNITED STATES DISTRICT COURT

WESTERN DISTRICT OF LOUISIANA

LAFAYETTE-OPELOUSAS DIVISION

EDWARD C. ABELL, JR.,
ET AL

VS.

CIVIL ACTION
NUMBER 84-1786

POTOMAC INSURANCE
COMPANY OF
ILLINOIS, ET AL

SECTION O

SPECIAL INTERROGATORIES
(Filed February 4, 1987)

1. Do you find by a preponderance of the evidence that any of the following parties violated Section 12(1) of the Securities Act of 1933 for offering and selling unregistered securities to the public, if required to be registered?

(Answer Yes or No)	Yes	No
Joe E. Fryar	✓	
Wright, Lindsey & Jennings and its insurers, Valley Forge Insurance Company	✓	
Rodney Kendrick	✓	

(Answer Yes or No)	Yes	No
All American Services Co, Ltd.	✓	
William Skye	✓	
Joseph D. Hancock and Hancock, Joseph & Daniel	✓	
Swink & Co., Inc.	✓	
John W. Peck	✓	

2. Do you find by a preponderance of the evidence that any of the following parties violated Section 12(2) of the Securities Act of 1933 for making material misstatements or omissions of material fact in connection with the offer or sale of the Westside Bonds?

(Answer Yes or No)	Yes	No
Joe E. Fryar	✓	
Wright, Lindsey & Jennings and its insurers, Valley Forge Insurance Company	✓	

(Answer Yes or No)	Yes	No
Rodney Kendrick	✓	
All American Services Co, Ltd.	✓	
William Skye	✓	
Joseph D. Hancock and Hancock, Joseph & Daniel	✓	
Swink & Co., Inc.	✓	
John W. Peck	✓	

3. Do you find by a preponderance of the evidence that any of the following parties violated Rule 10b-5(2) of the Securities and Exchange Act of 1934 by making any untrue statement of a material fact or by omitting to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading in connection with the purchase or sale of Westside Bonds?

(Answer Yes or No)	Yes	No
Joe E. Fryar	✓	
Wright, Lindsey & Jennings and its insurers, Valley Forge Insurance Company	✓	
Rodney Kendrick	✓	
All American Services Co, Ltd.	✓	
William Skye	✓	
Joseph D. Hancock and Hancock, Joseph & Daniel	✓	
Swink & Co., Inc.	✓	
John W. Peck	✓	

4. Do you find by a preponderance of the evidence that any of the following parties violated Rules 10b-5(1) and 10b-5(3) of the Securities & Exchange Act of 1934 for employing fraudulent, deceptive and manipulative acts and

practices in connection with the purchase or sale of Westside Bonds?

(Answer Yes or No)	Yes	No
Joe E. Fryar	✓	
Wright, Lindsey & Jennings and its insurers, Valley Forge Insurance Company	✓	
Rodney Kendrick	✓	
All American Services Co, Ltd.	✓	
William Skye	✓	
Joseph D. Hancock and Hancock, Joseph & Daniel	✓	
Swink & Co., Inc.	✓	
John W. Peck	✓	

5. Do you find by a preponderance of the evidence that any of the following parties aided or abetted violations of the securities laws under Rule 10b-5?

(Answer Yes or No)	Yes	No
Joe E. Fryar	✓	
Wright, Lindsey & Jennings and its insurers, Valley Forge Insurance Company	✓	
Rodney Kendrick	✓	
All American Services Co, Ltd.	✓	
William Skye	✓	
Joseph D. Hancock and Hancock, Joseph & Daniel	✓	
Swink & Co., Inc.	✓	
John W. Peck	✓	

6. Do you find by a preponderance of the evidence that any of the following parties, either as principals, or as aiders or abettors, violated the Louisiana Blue Sky Law for failure to register the securities, if required to be registered, with the Louisiana

Securities Commission or for making material misrepresentations and omissions in connection with the offer and sale of Westside bonds?

(Answer Yes or No)	Yes	No
Joe E. Fryar	✓	
Wright, Lindsey & Jennings and its insurers, Valley Forge Insurance Company	✓	
Rodney Kendrick	✓	
All American Services Co, Ltd.	✓	
William Skye	✓	
Joseph D. Hancock and Hancock, Joseph & Daniel	✓	
Swink & Co., Inc.	✓	
John W. Peck	✓	

7. Do you find by a preponderance of the evidence that any of the following parties, either as principals, or as aiders or abettors, violated Louisiana

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8. Do you find by a preponderance of the evidence that any of the following parties violated Section 1962(a) of the RICO Act?

(Answer Yes or No)	Yes	No
Joe E. Fryar	✓	
All American Services Co, Ltd.	✓	

9. Do you find by a preponderance of the evidence that any of the following parties violated Section 1962(b) of the RICO Act?

(Answer Yes or No)	Yes	No
Joe E. Fryar	✓	
All American Services Co, Ltd.	✓	

10. Do you find by a preponderance of the evidence that any of the following parties violated Section 1962(c) of the

RICO Act, for conducting or participating in the conduct of the affairs of an enterprise through a pattern of racketeering activity involving mail fraud, wire fraud, or violations of the federal securities laws?

(Answer Yes or No)	Yes	No
Joe E. Fryar	✓	
All American Services Co, Ltd.	✓	

11. If plaintiffs have shown that any parties violated any of the laws enumerated in Questions One through Six, plaintiffs must also show that by reason of the parties' violation of these laws, plaintiffs were injured.

Do you find by a preponderance of the evidence that plaintiffs were injured by reason of any party's violation of these laws?

(Answer Yes or No)

Yes ✓ No _____

(Note: If you answered this question "Yes" proceed to Question Twelve, Thirteen, Fourteen, Fifteen. If you answered this question "No" proceed to Question Sixteen.)

12. What amount of money do you find would compensate plaintiffs for the difference between the purchase price paid and the actual cash value of Westside bonds on the date those bonds were issued?

(Answer in Dollars) $ 0

13. What amount of money do you find would compensate plaintiffs for the difference between the rate or return which the plaintiffs were promised they would receive on their original

investment and the return they have actually received and will receive in the future?

(Answer in Dollars) $ 9,594,000.00

14. If you answered "Yes" to Question Seven, what amount of money, if any, do you find would compensate the plaintiffs for damages sustained as a result of intentional or negligent misrepresentations or omissions and/or for breach of fiduciary duty?

(Answer in Dollars) $ 2,200,000.00

15. If you answered "Yes" as to any party in Question One through Seven, what percentage, if any, of the damages do you attribute to each party that caused injury to the plaintiffs?

Joe E. Fryar	30%
All American Services Co, Ltd.	30%
Wright, Lindsey & Jennings and its insurers, Valley Forge Insurance Company	10%
Rodney Kendrick	5%
Joseph D. Hancock and Hancock, Joseph & Daniel	10%
William Skye	5%
Swink & Co., Inc.	5%
John W. Peck	5%

(Note: The total of the percentages given in your answer to Question Fifteen must equal 100%.)

16. If plaintiffs have shown that any party violated any of the laws enumerated in Questions Eight through Ten, plaintiffs must also show that, by reason of the parties' violation of these

laws, plaintiffs were injured in their business or property.

Do you find by a preponderance of the evidence that plaintiffs were injured in their business or property by reason of any party's violation of Sections 1962(a) and/or 1962(b) and/or 1962(c) of the RICO Act?

(Answer Yes or No)

Yes ✓ No _____

(Note: Proceed to Question Seventeen only if you answered this question "Yes." Proceed to Question Eighteen if you answered this question "No.")

17. What sum of money, if any, if paid now in cash, do you find from a preponderance of the evidence would fairly and reasonably compensate plaintiffs for their damages, if any, proximately caused by the parties'

violation of Sections 1962(a) and/or 1962(b) and/or 1962(c) of the RICO Act?

(Answer in Dollars and cents, if any)

Answer: $ 850,000.00

18. If you find that All American Services Co., Ltd. has committed violations of any of the laws enumerated in Questions One through Ten, do you further find that All American Services Co., Ltd. received a windfall profit as a direct and proximate result of these violations?

(Answer Yes or No)

Yes ✓ No _____

(Note: If your answer to Question Eighteen is "Yes", proceed to Question Nineteen. If your answer to Question Eighteen is "No", proceed to Question Twenty.)

19. What sum of money do you find from a preponderance of the evidence would fairly represent the amount of All American Services Co., Ltd.'s windfall profit.

(Answer in Dollars and cents.)

Answer: $ 2,950,000

20. Do you find by a preponderance of the evidence that David Menz and/or Wright, Lindsey & Jennings committed legal malpractice which was a legal cause of plaintiffs' damages?

(Answer Yes or No)

Yes ✓ No _____

(Note: If you answered "Yes" to Question Twenty, proceed to Question Twenty-one.)

21. What amount of money, if any, do you find would compensate the

plaintiffs for damage sustained as a result of the legal malpractice?

(Answer in Dollars) $ 300,000.00

SO SAY WE ALL.

/s/ Stephen M. illegible
FOREPERSON

Opelousas, Louisiana
Date: February 4, 1987.

UNITED STATES DISTRICT COURT

WESTERN DISTRICT OF LOUISIANA

LAFAYETTE-OPELOUSAS DIVISION

EDWARD C. ABELL, JR., ET AL.	*	CIVIL ACTION
	*	NO. 84-1786
VERSUS	*	
	*	SECTION "O"
POTOMAC INSURANCE COMPANY OF ILLINOIS, ET AL.	*	MAGISTRATE DIVISION

J U D G M E N T
(filed February 19, 1987)

This action came on for jury trial before the Court on December 8, 1986, with the Honorable John M. Shaw, District Judge presiding, and the issues having been duly tried and a verdict having been duly rendered in favor of plaintiffs on February 4, 1987;

IT IS ORDERED, ADJUDGED AND DECREED that there be judgment herein in favor of plaintiffs, Edward C. Abell, Jr. and

Carey Walton, and the class of purchasers of Westside Habilitation Center Revenue Bonds, and against defendants Joe E. Fryar, All American Services Company, Ltd., Wright, Lindsey and Jennings and Valley Forge Insurance Company jointly and severally in the full and true sum of $6,715,800, together with interest thereon at the rate of 12% from July 5, 1984, the date of judicial demand, until payment, together with taxable court costs and attorneys' fees as set forth below.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that there be judgment herein in favor of all plaintiffs and against defendants Joe E. Fryar, All American Services Company, Ltd., Wright, Lindsey & Jennings and Valley Forge Insurance

Company in solido in the full and true sum of $1,540,000, with interest thereon at the rate of 12% per annum from date of judicial demand until date of payment, together with taxable court costs and attorneys' fees as set forth below. This portion of the judgment is a part of and encompassed within the award made in the above paragraph. Hence, if recovery is had under the award made in the above paragraph, this portion of the judgment is duplicative and shall not be exigible.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that there be judgment herein in favor of all plaintiffs and against defendants, Joe E. Fryar and All American Services Company, Ltd., jointly and severally in the full and true sum of $2,550,000, together with interest

thereon from date of this judgment until date of payment, together with all costs of the suit and attorneys' fees as set forth below.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that there be judgment herein in favor of all plaintiffs and against All American Services Company, Ltd. in the full and true sum of $2,950,000, together with interest thereon from date of this judgment until date of payment.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that there be judgment in favor of all plaintiffs and against Wright, Lindsey and Jennings and Valley Forge Insurance Company in solido in the full and true sum of $300,000, together with interest thereon at the rate of 12% from

date of judicial demand until date of payment, together with all costs of these proceedings. This portion of the judgment is also encompassed within and a part of the award made in the first paragraph. Hence, if recovery is had under the award made in the first paragraph, this portion of the judgment is duplicative and shall not be exigible.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that there be judgment in favor of all plaintiffs and against Joe E. Fryar, All American Services Company, Ltd., Wright, Lindsey & Jennings, and Valley Forge Insurance, in solido, in the full and true sum of $2,567,323.80, representing reasonable attorneys' fees, together with taxable costs of this proceeding to be determined upon the

plaintiffs' submission of their bill of costs. Of this amount, only $2,117,323.00 shall be payable to counsel for plaintiffs and the balance shall be paid to the plaintiffs.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that there be judgment in favor of plaintiffs and against Joe E. Fryar and All American Services Company, Ltd., in solido, for the full true sum of $263,743.00, representing costs and expenses of this litigation compensable under the RICO statute but not taxable under 28 U.S.C. 1920. Of this amount, $64,071.29 shall be payable to counsel for plaintiffs and the balance shall be paid to plaintiffs.

OPELOUSAS, LOUISIANA, this 19th day of February, 1987.

ROBERT H. SHEMWELL,
Clerk of Court, United States
District Court for the Western
District of Louisiana
By: /s/ Mildred Baker
Mildred Baker, Deputy Clerk

Approved as to form:

/s/ John M. Shaw
John M. Shaw, United
States District Judge

Judgment Entered 2-19-87

By /s/ Rita V. Watkins

Notice to:

Wittman	Goudelocke
Ouris	Weens III
Hamilton III	Stafford, Jr.
Provosty, Jr.	Frankhauser
Odom	Nunnally, III
Smith	Downing
Humphries, Jr.	Welch
Breaux	Davidson
Sommer	Munsterman
Stahl	Mayer
Bienvenu	Schomp
Melichar	
Simon	
Alltmont	

Edward C. ABELL, Jr. and Carey Walton, Plaintiffs-Appellees Cross-Appellants,

v.

POTOMAC INSURANCE COMPANY, et al., Defendants,

Joe E. Fryar, Wright, Lindsey and Jennings, and Valley Forge Insurance Company, Defendants-Appellants Cross-Appellees.

No. 87-4260

United States Court of Appeals
Fifth Circuit.

Nov. 2, 1988.

Rehearing and Rehearing En Banc Denied
Dec. 14, 1988.

Bond purchasers brought action against developer whose company issued the bonds, bond counsel, and others. The United States District Court for the Western District of Louisiana, John M. Shaw, J., entered judgment on jury verdict in favor of plaintiffs on all

claims, and defendants appealed. The Court of Appeals, Jerry E. Smith, Circuit Judge, held that: (1) bond counsel and person whose corporation issued the bonds were not "sellers" for purposes of the Securities Act or the Louisiana Blue Sky Law; (2) statements were shown to be material; (3) plaintiffs could not use Ute presumption or fraud on the market theory to show reliance by class; (4) plaintiffs did not show any reliance on statements made by bond counsel; (5) bond counsel could not be held liable on breach of fiduciary duty or other theories with respect to nonclients; (6) attorneys were not vicariously liable; (7) plaintiffs established RICO violation by developer whose corporation issued the bonds; (8) plaintiffs were not limited to out-of- pocket damages; and (9) developer

did not show that he was prejudiced by jury's knowledge of his attempt to bribe one juror.

Affirmed in part, reversed in part, and remanded.

J. Minos Simon, Lafayette, La., for Fryar.

D. Mark Bienvenu, Lafayette, La., for Valley Forge.

Gene W. Lafitte, Edward J. Gay, III, Julie F. Schwartz, James D. McMichael, James A. Brown, New Orleans, La., for Wright, Lindsey & Jennings.

Leslie R. Leavoy, Jr., Alexandria, La., for All American Services, Ltd.

Phillip A. Wittmann, Kyle Schoenkas, Judy Y. Barrasso, C. Lawrence Orlansky, New Orleans, La., for plaintiffs-appellees cross-appellants.

Appeal from the United District

Court for the Western District of Louisiana.

Before THORNBERRY, WILLIAMS, SMITH, Circuit Judges.

JERRY E. SMITH, Circuit Judge:

This is a civil case involving securities fraud, racketeering, and pendent state law claims. The plaintiffs, a class of investors who own bonds issued by the Westside Rehabilitation Center ("Westside"), allege that Joe Fryar, Westside's developer, and Wright, Lindsey & Jennings ("WLJ"), a Little Rock, Arkansas, law firm representing the bond issue's underwriters, fraudulently caused Westside to default on its bond interest payments, ultimately causing the bondholders to lose millions of dollars. After a two-month trial, the jury

returned a multi-million-dollar verdict in favor of the plaintiffs and against Fryar, WLJ, and their two co-defendants, All American Services, Inc. ("All American"), and Valley Forge Insurance Company ("Valley Forge"). The district court, which rejected all the defendants' motions for judgment notwithstanding the verdict, entered judgment upon this verdict and awarded plaintiffs damages totaling approximately $15 million. All of the defendants appealed from this judgment, but we dismissed All American's appeal for failure to prosecute. We now reverse and render the judgment against WLJ and Valley Forge, and affirm in part the judgment of liability against Fryar, and remand for redetermination of damages, interest and attorney's fees.

I. Facts as to the Merits.[1]

Westside, a non-profit corporation based in Cheneyville, Louisiana, was masterminded by its developer, Joe Fryar. Fryar originally conceived of Westside as a home for the mentally retarded, but he eventually changed Westside's targeted clientele to severely mentally and emotionally-disturbed patients. Fryar then prepared to translate his ideas into reality.

First, Fryar purchased 6.47 acres of land and a thirty-year-old vacant school building in Cheneyville (the "Cheneyville property") from the Rapides Parish School Board on January 3, 1978, for the sum of $100,000, its appraised value. Fryar

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[1] We recite the facts of this case in the light most favorable to the jury's verdict.

then incorporated Westside in 1979. At its inception, Westside had no capital assets; rather, its sole source of revenue and assets initially was to be the sale of bonds. Thereafter, Westside would rely on revenues paid by the State of Louisiana Medicaid program, which revenues would be used to retire the bonds.

Fryar hired his attorney, William Skye, to prepare the incorporation papers. Although a five-member board of directors was appointed, the board never collectively made any decisions on behalf of Westside. Rather, Fryar continued to control Westside and make all its decisions, including the purchase price for the Cheneyville property and the fees to be paid Fryar. Throughout the period relevant to this appeal, Fryar continued

to run Westside.

Fryar's initial problems involved obtaining a certificate of need for Westside[2] and the capital funds necessary to launch the project. Ultimately, Westside succeeded in obtaining its certificate of need, despite some opposition from officials in the Louisiana Department of Health and Human Resources. Fryar, however, found it considerably more difficult to procure capital funding for Westside.

Fryar knew that building the Westside facility and starting up its operations would cost millions of

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[2] Medical facilities that receive Medicaid reimbursements must have a certificate of need. Since Westside was designed to rely upon Medicaid as its only source of funding, Westside's existence depended upon Fryar's ability to obtain that certificate.

dollars. To raise the needed capital, he decided to market bonds. Initially, Fryar hired the nationally-known financial feasibility firm of Booz, Allen & Hamilton, Inc. ("Booz, Allen"), to evaluate the Westside project.

Booz, Allen dealt the Westside project its first blow. In a report dated July 23, 1979, the firm concluded that Westside was not financially feasible. Booz, Allen found several areas of concern, including (1) the possibility that the state medicaid program would impose ceilings on medicaid reimbursement; (2) the difficulties Westside would encounter in retiring its debt, since it depended entirely upon medicaid reimbursements and lacked adequate sources of working capital; and (3) the inherent faults of the Westside

concept in a state whose prevailing policies required placing Westside's potential patients in group homes.

The study caused Fryar to change his targeted clientele to emotionally-disturbed and mentally-retarded patients, but even this change did not alter Booz, Allen's decision. After Fryar threatened Booz, Allen with suit because of its adverse conclusions, Booz, Allen agreed to sign a letter drafted by WLJ's predecessor as bond counsel, the Boston law firm of Mintz, Levin, Cohn, Ferris, Glovsky & Popeo ("Mintz, Levin"). That epistle noted only the change in clientele and stated that Booz, Allen's conclusions may not necessarily still be applicable. The letter from Booz, Allen did not solve Fryar's problems, because he still did not have a favorable

feasibility study.

Undeterred, Fryar retained Real Estate Research Corporation ("RERC"), experienced primarily in appraising real estate, to conduct a feasibility study. RERC ultimately delivered a favorable report. Meanwhile, Fryar encountered other difficulties in effecting a bond issue to fund Westside. he initially asked the Louisiana State Bond Commission for permission to finance the project through the Louisiana Public Facilities Authority; citing a variety of concerns, the Commission declined to approve financing for Westside bonds. Shortly thereafter, Westside's bond counsel, the New York law firm of Mudge, Rose, Guthrie & Alexandrer, resigned. Some time later, Westside retained John W. Peck of Peck, Shaffer & Williams as the new bond

counsel.

Ultimately, Fryar convinced the Town of Cheneyville to back a $12,850,000 municipal bond issue. Later, and somewhat mysteriously, the bond authorization was increased to $18,550,000. Having described Fryar's long and successful struggle to obtain backing for the bond issue, we turn to how Fryar arranged Westside's finances.

Fryar had determined that he needed to receive over $5,000,000 to renovate, construct, and operate the Westside facility for an estimated seven months until it became self-sufficient. Westside's final offering statement for the bonds indicates that Westside also planned to expend over $3,200,000 in interest payments on the bonds, over $2,100,000 for debt service, more than

$1,000,000 as an underwriter's discount, and $2,459,700 for "acquisition of center." The offering statement does not reveal in explicit detail how Westside actually acquired its facilities, and the failure of the offering statement to explain that transaction more thoroughly is at the heart of this multi-million-dollar litigation.

Fryar planned to issue the revenue bonds in the following denominations and maturities:

Interest Rate	No. of Bonds	Face Amount	Total Amount	Due Date
16.50%	7,790	$5,000	$ 8,950,000	Oct. 1, 2013
16.25%	80	5,000	400,000	Oct. 1, 2002
16.00%	40	5,000	200,000	Oct. 1, 1998
14.00%	800	5,000	4,000,000	Oct. 1, 2013
	2,710		$13,550,000	

Until late 1981, Fryar owned the property eventually used to establish Westside. In 1981, he either contacted or helped create All American , a Bermuda corporation. Frequently using the mails and the wires to communicate messages and transmit documents, Fryar and All American eventually devised a complicated transaction to dispose of Fryar's interest in the land. Fryar, who had bought the land in 1978 for $100,000, agreed to sell this land to All American for $150,000. All American then sold the land to Westside for $2,479,000 - $2,000,000 in Westside bonds and the remainder in cash. All American, retaining its ownership interest in the bonds, allowed Fryar to pledge those bonds to secure Fryar's performance of his duties as the developer of the

project.

This transaction accomplished several things for Fryar and All American. First, it allowed Fryar to make a 50-percent up-front profit from owning the land for only three years. Second, it produced a profit for All American of over $2,300,000 - a profit which by itself was over 15 times what All American had originally paid. Third, it allowed All American to enjoy the benefits of owning $2,000,000 worth of tax-exempt municipal bonds, including the interest payments periodically due on those bonds. Finally, it allowed Fryar to claim that he had pledged over $2,000,000 of bonds to the completion of the Westside project and thus to imply that he had over $2,000,000 of his own money at risk in the project.

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At this point, Fryar began to rely

upon the professionals preparing the Westside bonds for market. Those professionals included Joseph Hancock and his underwriting firm, Hancock, Joseph & Daniels; Skye, Westside's attorney; Peck, whose firm of Peck, Shaffer & Williams continued to serve as bond counsel; Robert Sheddy of Swink & Co., the other underwriter for the bond issue; and Mintz, Levin, then counsel for the two underwriters. Just before Westside's scheduled closing and issuance of the bonds, Mintz, Levin resigned as underwriter's counsel, purportedly because the associate working on the Westside bond offering left Mintz, Levin to join another law firm. When that associate departed in February 1982, there were only a few weeks left until Westside was scheduled to close its bond

deal with the underwriters.

Under these circumstances, the underwriters immediately hired WLJ as their counsel. WLJ at once launched into preparing the bond offering to satisfy the securities laws of two dozen or more states. At the same time, WLJ assumed strict "due diligence" duties. WLJ was responsible (to its clients, at least) for carefully reviewing the final offering statement and for interviewing all the key participants to the bond transaction and those people necessary to the success of Westside project. According to the expert testimony of James Perkins, an experienced securities lawyer from Boston, WLJ failed seriously in its due diligence duties to investigate the bond transaction, and thus failed to uncover the details of the

Cheneyville land transaction and some of the details of Westside's history.

The offering statement, which the underwriters (WLJ's new clients) prepared, contained many of the relevant facts bearing on the Westside project. However, the offering statement did not reveal everything we now know. For instance, the final offering statement did not contain any information about the Booz, Allen report.[3] Moreover, the final offering statement reported that All American had sold the Cheneyville land to Westside for $2,479,000, but it did not

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[3] David Menz, the WLJ partner who represented the underwriters, testified that he thought the Booz, Allen feasibility report was irrelevant because the subsequent Booz, Allen letter seemed to suggest that the change in targeted clientele made the old report obsolete.

add that Fryar had once owned the land, nor did it report any of the details of the transaction between Fryar and All American. Finally, the offering statement reported flatly that Fryar had pledged $2,000,000 of Westside bonds to the success of the project, leaving the distinct impression, even in Menz's mind, that Fryar had purchased the bonds himself and with his own money.

On April 20, 1982, the underwriters and Westside closed the bond deal. The underwriters subscribed to the entire issue of bonds and undertook the task of selling it. The underwriters sold the bonds at approximately par value (except for the 14% bonds, which were sold at a discount). The underwriters found no difficulty in selling Westside bonds, and the entire issue was marketed quickly.

Two of the new investors in Westside bonds were plaintiffs Carey Walton and Edward Abell, both of whom testified that they bought their bonds from Dick Hardwick, a broker for Swink. Walton said he relied upon the integrity and competence of the broker, with whom he had dealt before, and upon a flyer Swink had circulated without WLJ's advice, knowledge, or control. Abell testified that he relied upon Walton's glowing reports and Walton's confidence in Swink and its broker.

Both Abell and Walton testified that they would have evaluated Westside bonds differently had they known about the Booz, Allen study, the details of the Cheneyville land transaction, and the fact that Fryar had not pledged any of his own bonds or his own money to

complete the project. Both witnesses stressed heavily that the developer's apparent willingness to put $2,000,000 of his own money into the project impressed them greatly and influenced their decisions implicitly.

Over the next year and a half, the Westside story began to unravel. A bank failure and several delays cost Westside a substantial sum, though no more than $300,000. A local newspaper began to uncover the details of the Cheneyville land transaction. Litigation arising from the bank failure forced Swink to send a reassuring letter to all bondholders. In that letter, dated January 20, 1983, however, Swink revealed all the information that had been withheld from the offering statements.

In early July 1984, Abell and

Walton initiated this lawsuit on behalf of themselves and a class of 500 of Westside's bondholders. At that time, and for the next three months, Westside bonds continued to sell at or near their par value.

In October of 1984, Westside's financial structure finally collapsed. Westside defaulted on an interest payment on its bonds and ultimately was forced to file for Chapter XI bankruptcy in March 1985. The bondholders did not fare well in bankruptcy and, under Westside's reorganization plan, are now entitled to considerably lower interest payments than originally promised.[4] As a result of its

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[4] The bond indebtedness was restructured in bankruptcy so as to reduce the interest rates of the bonds as follows:

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bond in a timely fashion, and we have already dismissed its appeal for lack of prosecution. We now turn to the issues concerning each of the other three defendants, and to the question of whether they deserve a new trial because of jury tampering.

II. Section 12 of the Securities Act

First, the bondholders assert that Fryar and WLJ owe them rescissionary damages under section 12 of the Securities Act, 15 U.S.C. §771. WLJ and Fryar interpose a variety of defenses, among which is the claim that neither qualifies as a "seller" under either section 12(1) or section 12(2). Since only a statutory "seller" can be held liable under section 12, this defense, if correct, would completely absolve WLJ and Fryar.

We begin our analysis, as always, with the language of the statute itself. Under section 12, "[a]ny person who . . . offers or sells a security" in violation of the section's provisions "shall be liable to the person purchasing such security from him." 15 U.S.C. §771.[6]

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[6] Section 12 reads in its entirety:

> Any person who -
>
> (1) offers or sells a security in violation of section 77e of this title, or
>
> (2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser

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We do not begin with a blank slate, however, since the Supreme Court has recently interpreted this language authoritatively.

In Pinter v. Dahl, ___ U.S. ___, 108 S.Ct. 2063, 100 L.Ed.2d 658 (1988), the Supreme Court decided whom courts may treat as "sellers" under section 12. Pinter, an oil and gas producer who sold

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> not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

securities, sought contribution from Dahl to satisfy a judgment in favor of investors who had purchased unregistered securities from Pinter. Pinter argued that Dahl should share in Pinter's section 12(1) liability,[7] since Dahl had actively promoted the securities among his friends and relatives, the disgruntled investors in the original suit. Dahl replied that he had merely recommended the Pinter securities because he had thought that they would benefit their owners. Dahl argued that he could not be a "seller" under section 12(1) because he had not acted from a motivation of personal gain.

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[7] Section 5 of the Securities Act, 15 U.S.C. §77e, prohibits the sale of unregistered securities not exempted under section 3 of the Securities Act, 15 U.S.C. §77c.

The Court first analyzed the language of the statute which we have set out above. The Court noted that the term "seller," which includes anyone who "offers . . . a security," is not restricted to those who pass title in securities to investors:

> Section 2(3) defines 'sale' or 'sell' to include 'every contract of sale or disposition of a security or interest in a security, for value,' and the terms 'offer to sell,' 'offer for sale,' or 'offer' to include 'every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.' 15 U.S.C. §77b(3).... The inclusion of the phrase 'solicitation of an offer to buy' within the definition of 'offer' brings an individual who engages in solicitation, an activity not inherently confined to the actual owner, within the scope of §12.... 'The statutory terms ["offer" and "sell"], which congress expressly intended to define broadly, ... are expansive enough to encompass the entire selling process, including the seller/agent transaction.'

Pinter, 108 S.Ct. at 2076-77 (quoting

United States v. Naftalin, 441 U.S. 768, 773, 99 S.Ct. 2077, 2082, 60 L.Ed.2d 624 (1979)).

Although the Court held that the "offers or sells" phrase in section 12 does not limit greatly the scope of section 12(1), it reasoned that the "purchase from" language of section 12 further restricts the range of potential sellers. The Court held that a defendant is not a "seller" unless the defendant "would commonly be said, and would be thought by the buyer, to be among those 'from' whom the buyer 'purchased'...." Id. at 2077. Siding with Dahl, the Court added:

> When a person who urges another to make a securities purchase acts merely to assist the buyer, not only is it uncommon to say that the buyer 'purchased' from him, but it is also strained to describe the giving or gratuitous advice, even strongly or enthusiastically, as 'soliciting.'

> ... The language and purpose of §12(1) suggest that liability extends only to the person who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner.

Id. at 2078-79.

The definition of "seller," as the Pinter court has articulated it, requires us to make two inquiries: (1) Who passed title to the plaintiff or solicited the transaction in which title passed; and (2) from whom did the plaintiff buy the security? We may answer the first question according to the standards of legal parsing and linguistic analysis, but to answer the second question, we must refer to common usage.

Here, all of the plaintiffs bought Westside bonds from brokers or previous owners. Some of the plaintiffs, like Abell and Walton, bought their bonds from

employees (who were brokers) of Wink & Co., one of the underwriters. It might be said that everyone who invested in the initial offering bought from the underwriters and Westside, the issuer.[8] None of the investors, however, can say that he or she bought bonds from the developer of the project which the bond issue supports, or from one of the law

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[8] Like automobile manufacturers, issuers create distribution chains composed of independent businesses aligned for a single purpose: to sell the product. Just as Ford and General Motors never sell directly to consumers, many issuers never sell their securities directly to investors. Nonetheless, automobile manufacturers engage in intensive marketing campaigns to convince the public to buy their products from dealerships readily identified with the manufacturer. Consequently, one often hears that someone "has bought a new car from Ford." To the extent that issuers and underwriters use an analogous system to distribute securities, they too may be sellers from whom one buys products.

firms that helped to prepare the offering statement. If we apply the principles of Pinter to this case, we must hold that neither Fryar nor WLJ is a "seller" under section 12(2).

The bondholders suggest that Pinter is inapposite here. They do not deny that the "sell or offer" and "purchase from" language of section 12(2) is identical to the language the Court interpreted in Pinter. They note, however, that the Court explicitly reserved the right to interpret the section 12(2) language differently. See 108 S.Ct. at 2076 n. 20.

The plaintiffs contend that policy reasons favor divergent interpretations of the identical words of sections 12(1) and 12(2). They argue that the Court singled out section 12(1) because it

imposes strict liability upon anyone who sells unregistered securities. Rather than import fault-based concepts, including proximate cause, to interpret section 12(1), the Court stuck closely to the language of section 12(1).

Thus, the Court (so sayeth the bondholders) rejected the substantial-factor test previously applied in this circuit[9] because that test defines as a "seller" anyone who proximately caused a securities transaction. The bondholders

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[9] We previously had defined a "seller" as (1) one who parts with title to securities in exchange for consideration or (2) one whose participation in the buy-sell transaction is a substantial factor in causing the transaction to take place. Dahl v. Pinter, 787 F.2d 985, 990 (5th Cir. 1986), vact'd, ___ U.S. ___, 108 S.Ct. 2063, 100 L.Ed.2d 658 (1988) (citing our prior cases), on remand, 857 F.2d 262 (5th Cir. 1988)

argue that the Court would accept the substantial-factor analysis to determine who is a section 12(2) seller because Congress incorporated traditional fault concepts into the elements of that subsection.

The Court, however, explicitly based its interpretation upon the plain language of section 12(1), not upon other factors, and presumably would do the same with section 12(2). Pinter teaches that

> [t]he deficiency of the substantial-factor test is that it divorces the analysis of seller status from any reference to the applicable statutory language and from any examination of §12 in the context of the total statutory scheme.... Thus, although the substantial-factor test undoubtedly embraces persons who pass title and who solicit the purchase of unregistered securities as statutory sellers, the test also would extend §12(1) liability to participants only remotely related to the relevant aspects of the sales transaction. Indeed, it might expose securities professionals, such as accountants

> and lawyers, whose involvement is only the performance of their professional services, to §12(1) strict liability for rescission. The buyer does not, in any meaningful sense, "purchas[e] the security from' such a person.

108 S.Ct. at 2080-81 (footnote omitted, emphasis added). Finally, the Court issued this warning:

> 'The ultimate question is one of congressional intent, not one of whether this Court thinks it can improve upon the statutory scheme that Congress enacted into law.' Touche Ross & Co. v. Redington, 442 U.S. [560] at 578, [99 S.Ct., 2479, at 2490, 61 L.Ed.2d 82 (1979)].... The ascertainment of congressional intent with respect to the scope of liability created by a particular section of the Securities Act must rest primarily on the language of that section. See Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 472 ... [97 S.Ct. 1292, 1300, 51 L.Ed.2d 480] (1977).

Id. at 2082.

We cannot ignore so plain a command. We hold that neither Fryar nor WLJ was a "seller" under section 12.

III. Rule 10b-5 Claims.

Plaintiffs claim further that the defendants committed securities fraud in violation of section 10(b) of the Exchange Act. "To make out a claim under Section 10(b), which is based on the common law action of deceit, the plaintiff must establish (1) a misstatement or an omission (2) of material fact (3) made with scienter (4) on which the plaintiff relied (5) that proximately caused his injury." Huddleston v. Herman & McLean, 540 F.2d 534, 543 (5th Cir. Unit A Mar. 1981), rev'd in part on other grounds, 459 U.S. 375, 103 S.Ct. 683, 74 L.Ed.2d 548 (1983).[10] The plaintiffs claim that they

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[10] Section 10(b) plaintiffs must also prove that the defendants committed the alleged fraud "in connection

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introduced substantial evidence to prove each of these elements against each of the defendants.

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with a purchase or sale of securities," but that element is not in doubt here.

§10(b) reads, in relevant part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange - ...
>
> (b) to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest for the protection of investors.

Rule 10b-5 reads:

> It shall be unlawful for any person, directly or indirectly, by the use of any

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The defendants do not assert that they never said or wrote anything false or misleading. However, the defendants do challenge the legal sufficiency of the bondholders' proof of materiality, reliance, and causation. WLJ also argues that it did not have the necessary scienter to violate rule 10b-5.

> means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.
>
> 17 C.F.R. §240.10b-5 (1987).

We will consider materiality first, followed by causation and reliance. Later, we will discuss WLJ's scienter arguments when we examine the potential for derivative rule 10b-5 liability under theories which the bondholders aim specifically at WLJ.

A. Materiality.

The defendants contend that the plaintiffs' complaints were not material. The defendants (but especially Fryar) question whether Westside said (or failed to disclose) anything that would have affected any investor's decision to buy Westside bonds. Defendants point out that none of the facts they distorted made any difference to investors when ultimately, in a January 1983 letter,

Westside revealed all relevant facts.'' Despite these revelations, the price (and apparently, the trading volume) of Westside bonds remained stable. Neither did the commencement of this lawsuit have any appreciable affect upon the market value of Westside bonds. From these facts, defendants conclude, as a matter of law, that the information which plaintiffs allege Westside fraudulently withheld was not material.

'' That letter, designed to calm investors' fears, disclosed the $2.4-million profit Fryar and All American collectively had made from selling land to Westside. It also revealed that Fryar used the money generated from this land transaction, not money originally his own, to secure his personal bonds backing the project. Finally, the letter reported the negative assessment which Booz, Allen had made of Fryar's 1983 Westside plans.

We begin by reviewing the standard for determining when a fact is material. For the purposes of the securities laws, "[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976). To be a material fact, "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." Id. The court has recently adopted these tests to determine materiality in all rule 10b-5 cases. Basic Inc. v. Levinson, ___ U.S. ___, 108 S.Ct. 978, 983, 99 L.Ed.2d 194 (1988).

Given this standard, we believe that the record sufficiently supports plaintiffs' position. The jury was entitled to believe that information that would have affected the market for Westside's initial offering would not have had the same effect two or three years later. Indeed, the jury heard expert testimony that Westside could not have marketed its bonds at all had it revealed the details of the Fryar-All American-Westside land transaction or of the Booz, Allen study.

Sheddy, who on behalf of underwriter Swink helped prepare the offering statement, admitted that the unreported facts were material. The brokers at Swink's Atlanta office deemed the information so significant that they offered to buy back Westside bonds from

their customers when they first learned the truth. According to one of these brokers, Fryar's assurances that his own funds backed Westside significantly enhanced the project's image as a secure investment. This evidence sufficiently supports the jury's conclusions that Abell proved that a reasonable investor would have evaluated Westside's initial offering differently had all the information been available originally.

B. Causation.

Fryar attacks the sufficient of the evidence to prove that Westside misrepresented facts that caused its eventual bankruptcy and thus the reduction in the interest rates the bonds bore. To prove causation, the bondholders must prove

> That the untruth was in some reasonably direct, or proximate, way

> responsible for [their] loss. The causation requirement is satisfied in a Rule 10b-5 case only if the misrepresentation touches upon the reasons for the investment's decline in value. If the investment decision is induced by misstatements or omissions that are material and that were relied on by the claimant[s], but are not the proximate reason for [their] pecuniary loss, recovery under the Rule is not permitted.

Huddleston, 640 F.2d at 549 (footnote omitted).

Fryar asserts that the facts Abell would like to have known when Westside first offered its bonds have nothing to do with the causes of Westside's default on interest payments or its eventual bankruptcy.[12] He blames the bankruptcy of Penn Square Bank, which he contends dramatically affected Westside's cash

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[12] Westside's reorganization plan significantly lowered the interest rate borne by Westside bonds.

position at a critical point in the project's development. Fryar argues that a change in state health-care reimbursement policies destroyed whatever hope Westside had of weathering its cash flow crunch. According to Fryar, these two combined factors forced Westside into bankruptcy.

The jury, however, found otherwise. The Cheneyville land transaction consumed a substantial portion of Westside's working capital. Of a $13.5 million bond offering, nearly $2.5 million - most of which Fryar and All American secreted for their own undisclosed use - was dedicated to this single transaction. In comparison, the Penn Square Bank failure cost Westside on $300,000 at most. Indeed, Fryar's own witness conceded that state healthcare officials froze

reimbursements to Westside when they first learned of the true details of the Cheneyville land transaction. The jury was entitled to believe that this real estate deal "touched upon" the reasons for Westside's ultimate bankruptcy.[13] Hence, causation was sufficiently established.

C. Reliance.

The defendants also argue that the plaintiffs failed to prove that any plaintiff relied upon any fraudulent representations or omissions. The

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[13] We express no opinion regarding any other of Abell's theories of this case (e.g., that the Booz, Allen study revealed otherwise-undisclosed facts that contributed to Westside's bankruptcy). Our task is not to justify the jury verdict, but to ascertain whether the evidence sufficiently supported at least one view of the facts to permit a verdict for the plaintiffs.

element of reliance is the subjective counterpart to the objective element of materiality. Whereas materiality requires the plaintiff to demonstrate how a "reasonable" investor would have viewed the defendants statements and omissions, reliance requires a plaintiff to prove that it actually based its decisions upon the defendants' misstatements or omissions. "Reliance is cause sine qua non, a type of 'but for' requirement: had the investor known the truth he would not have acted." Huddleston, id. at 549 (footnote omitted). Thus,

> [c]ourts sometimes consider the reliance component of the Rule 10b-5 action to be a part of the causation element. In this context, the term 'transaction causation' is used to describe the requirement that the defendant's fraud must precipitate the investment decision.... On the other hand, 'loss causation' refers to a direct causal link between the misstatement and the claimant's economic loss.

Id. at 549 n. 24 (citation omitted).

1. Proving Reliance for the Class as a Whole.

Since rule 10b-5 plaintiffs must prove that each plaintiff subjectively relied upon the defendants misstatements and omissions, the jury may not infer the reliance of an entire class of plaintiffs from the testimony of a few. "Consequently, in a class action, while the materiality element can be established for the class as a whole, reliance, like damages, is a matter of individual proof." Huddleston, id. at 549 (citation omitted).

Here neither side introduced any evidence to demonstrate or refute whether most of the class members decided to buy Westside bonds in reliance upon what the defendants said or failed to say.

Whether the jury was permitted to infer reliance from the evidence, therefore, depends entirely upon who bore the burden of persuasion. That burden ordinarily rests with plaintiffs, but it may shift in those rare cases in which plaintiffs can prove that they are entitled to one of two presumptions.

The more venerable presumption, the so-called Ute presumption, is available to plaintiffs who can prove that the rule 10b-5 violations which they allege actually stem from defendants' failure to disclose pertinent information rather than from defendants' failure to tell the truth. The other presumption plaintiffs may invoke - the theory that defendants committed a fraud upon the marketplace - is of more recent vintage. We discuss each of these burdenshifting presumptions

in turn.

a. The Ute Presumption

The Ute presumption was first announced by the Supreme Court in Affiliated Ute Citizens v. United States, 406 U.S. 128, 92 S.Ct. 1456, 31 L.Ed.2d 741 (1972). There, an organization of native Americans organized a corporation to distribute its assets to its members. Each member received title to ten shares of stock that were deposited with a local bank. The bank entered into a fiduciary relationship with the new stockholders and assumed primary responsibility for enforcing title restrictions and providing other services related to the stock.

Ultimately, investors in surrounding communities developed an interest in the stock, and demand in these communities

outstripped the Utes' demand for the corporation's stock. The bank seized this opportunity quietly to build a non-native American clientele eager to invest in Ute stock. The native Americans, however, never heard about this secondary market for their stock, and the bank chose to keep them ignorant to exploit its potential financial gains.

When the Utes eventually did learn of the bank's scheme, eighty-five of them sued. The plaintiffs were Utes who, trusting in the bank, had sold their stock to the bank for prices that sometimes were significantly lower than what the bank could command in the open market. The native Americans complained that the bank had breached a fiduciary duty to them to disclose information about the secondary market, and sued the

bank for violating rule 10b-5. The bank responded in part by arguing that the plaintiffs had failed to prove reliance.

The Supreme Court held that the burden of proving reliance fell on the bank, not on the plaintiffs. As our subsequent cases have taught, the Ute presumption attaches only to those rule 10b-5 actions based primarily upon omissions rather than misrepresentations.[14]

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[14] To state a claim under rule 10b-5, a plaintiff must allege either that the defendant misrepresented material facts or omitted material facts which a pre-existing duty required it to disclose to the plaintiff. We have held that claims based upon misrepresentations sound in part 2 of rule 10b-5, whereas claims based upon omissions are founded upon parts 1 and 3 of the rule. See, e.g., Finkel v. Docutel/Olivetti Corp., 817 F.2d 356, 359-60 (5th Cir. 1987), cert denied, ___ U.S. ___, 108 S.Ct.

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Misrepresentations include statements that are themselves false - outright lies - and true statements that are nonetheless so incomplete as to be misleading, i.e., distorted half-truths. To omit a fact, however, is to say absolutely nothing about matters whose very existence plaintiffs have no reason to consider. The bank in Ute omitted material facts: The Utes simply had no idea that the bank itself actively solicited non-native-American investors to buy Ute stock.[15] These omissions were

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1220, 99 L.Ed.2d 421 (1988). See supra no. 10 for the text of rule 10b-5.

[15] To define more vividly the distinction between misrepresentations and omissions, we suggest the following hypothetical: Suppose a car owner, wishing to sell her vehicle, advertises in the newspaper that her

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not distorted half-truths, since the bank never made any statements regarding its activity in the secondary market.

Our cases indicate that the Ute presumption is limited to cases, like Ute

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(Continued from previous page) car has a "new" battery when she knows the battery is five years old. She has communicated an outright lie, and the basis of a fraud against her is falsehood (a category of misrepresentation). If a prospective buyer asks her, "How is the engine?", she might reply, "I've never had a problem with it." If, however, she has owned the car for only a few weeks, and knows that the previous owner had the engine rebuilt two months ago, she has distorted the truth by telling only part of it - another form of misrepresentation. Finally, assume the owner has decided to sell her automobile because a mechanic she knows considers the vehicle "not safe at any speed." Nonetheless, she tells this only to potential buyers who specifically ask her why she is selling the car. In this last case, the owner has omitted saying something about a particular material matter.

itself, in which the plaintiffs have based their complaint primarily upon alleged omissions. Such non-disclosures suits are those in which the complaint is grounded primarily in allegations that the defendant has failed to disclose any information whatsoever relating to material facts about which the defendants has a duty to the plaintiff to disclose. Ute, however, does not require the burden of persuasion to shift in cases where the plaintiffs allege either that the defendant has made false statements or has distorted the truth by making false but misleading incomplete statements. Thus, we apply the Ute presumption in non-disclosure cases, but not in falsehood of distortion cases. See, e.g., Finkel, 817 F.2d 359.

Here the bondholders characterize this case as involving primarily omissions. Their claim is that the offering documents represented that Westside was feasible, when it was not; that Fryar was to have $2 million of his own money in the transaction, when he did not; and that the real estate had a value or cost basis to Westside of over $2.4 million, when it did not. Although we have held these statements to have been both false and material, they are distortions, not omissions.

The bondholders have not argued that Fryar failed to disclose facts about which the investors had no inkling, but that Fryar purposely revealed only part of the truth in an effort to mislead potential purchasers. The plaintiffs attempted to portray the defendants as

creating an impression of Westside that was entirely false, induced by a deceptively misleading impression bout the offering; thus the plaintiffs are not entitled to the Ute presumption.

b. The Fraud-on-the-Market Presumption

The bondholders argue that we should assume that they relied upon the market for Westside bonds to set a fair price unadulterated by fraud. Under this theory of their case, the bondholders essentially contend that investors uniformly assume that an active and open securities market efficiently assimilates information about securities. The market then calibrates the price of a security to reflect precisely the security's value in light of all the information publicly available about that security. Provided that the publicly available information

is both accurate and complete, the market price contains the most accurate and succinct estimation of the true value of any given security at any given time. Consequently, investors, who must assume the integrity of the market and of those who trade in it, ordinarily rely heavily upon the market price in determining the values of securities.

This theory of the marketplace underlies a recent development in securities law - the "fraud-on-the-market" theory of reliance. A "fraud on the market" is any deceit that successfully disseminates false or misleading information into the securities market or withholds vital information from that market. Such a deceit defrauds investors even when they are unaware of the misrepresentations or

omissions that skew the market price, because investors depend heavily upon the integrity of the market price. Thus, the argument goes, courts should presume reliance in a class action because most (if not all) of the investors have relied upon the accuracy of a fraudulently distorted market price. See, e.g., Basic In. v. Levinson, 108 S.Ct. at 988-92.

In recent years, this theory of reliance rapidly has gained support. In Shores v. Sklar, 647 F.2d 462 (5th Cir. May 1981) (en banc), cert. denied, 459 U.S. 1102, 103 S.Ct. 722, 74 L.Ed.2d 949 (1983), we adopted a form of the fraud-on-the-market presumption of reliance. Since Shores, the Supreme Court in Basic Inc. v. Levinson has announced its support for a new, largely undefined version of this presumption of reliance.

Basic states only three propositions of law that are of interest here. First, the Court ruled that a trial court may presume reliance on the ground that the defendants committed a fraud on the market. Second, Basic explicitly holds that the "fraud-on-the-market" presumption is rebuttable and serves only to shift the burden of persuasion, as to reliance, onto securities fraud defendants. Finally, the Court vitiated part of our fraud-on-the-market jurisprudence.

Until Basic, we made the fraud-on-the-market presumption, like the Ute presumption, available only to plaintiffs who based their rule 10b-5 claims primarily upon nondisclosure. See, e.g., Finkel v. Ducotel/Olivetti Corp., 817 F.2d at 359. Basic, however, held that a

rule 10b-5 plaintiff alleging active misrepresentation (i.e., making false statements and failing to correct distorted statements) may also assert a fraud-on-the-market theory of reliance.[16]

> Recent empirical studies have tended to confirm Congress' premise that the market price of share traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations.... Indeed, nearly every court that has considered the proposition has concluded that where materially misleading statements have been disseminated into an impersonal, well-developed market for securities, the reliance of individual plaintiffs on the integrity of the market price may be presumed.... An investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. Because most publicly available information is reflected in market

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[16] The plaintiffs in Basic were former stockholders in a company that falsely denied the existence of merger talks. The plaintiffs sold their stock before the merger negotiations drove up stock prices.

> price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action.

Basic, 108 S.Ct. at 991-92 (footnotes omitted). Nonetheless, Basic essentially allows each of the circuits room to develop its own fraud-on-the-market rules. Consequently, we return to our own cases.

In Finkel, the most recent Fifth Circuit case to consider the fraud-on-the-market theory, we held that a rule 10b-5 plaintiff may establish fraud on the market in two different ways. First, the plaintiff can establish that the subject securities were traded on an active secondary market, such as a public exchange. In such a case, the plaintiff would prevail if he could prove that the defendant's non-disclosures materially affected the market price of the

security. 817 F.2d at 364.

Where, however, no active, efficient secondary market existed in which to trade the subject securities (as in Shores), the plaintiff must prove that "the defendants" conspired to bring to market securities that were not entitled to be marketed." Id. at 362. Shores states this same concept in slightly different terms:

> If [the plaintiff] proves no more than that the bonds would have been offered at a lower price or a higher rate, rather than that they would never have been issued or marketed, he cannot recover.... This theory is not that [the plaintiff] bought inferior bonds, but that the Bonds he bought were fraudulently marketed. The securities laws allow an investor to rely on the integrity of the market to the extent that the securities it offers to him for purchase are entitled to be in the market place.

Shores, 647 F.2d at 470-71.

The plaintiffs here argue first that

the market price, set in active bond markets, was distorted by defendants' fraud. The bondholders contend that Westside bonds were traded in an active secondary market through brokers. They add that Westside's finances, of which the public originally had only a materially distorted view, eventually caused the value of the bonds to collapse.

This argument, however, completely ignores Shores, which, in this respect, is factually indistinguishable from the present case. In Shores, as here, the defendants included private entrepreneurs who obtained a town's authorization to issue municipal bonds underwriting a local, private project. Both here and in Shores, the entrepreneurs hired underwriters to sell the new issue to the

public. In both cases, a small secondary market, exploited by brokers, developed for the bonds. However, the bonds in Shores, like the bonds here, were not actively traded on any exchange or in any large secondary market. As we observed later in Finkel,

> ... it is clear that the market for the bonds in Shores (industrial development bonds of the town of Frisco City, Alabama) does not represent the active, efficient market for which the fraud on the market theory was initially conceived.

Finkel, 817 F.2d at 364.

Next, the bondholders argue that they deserve the fraud-on-the-market presumption because the Westside offering was not entitled to be marketed. The bondholders point to several experts who testified that the Westside bonds were unmarketable. According to the plaintiffs' experts, Westside could not

have disclosed its true financial status and the negative conclusions of the Booz, Allen feasibility study without completely losing a market for their bonds. These experts also opined that no underwriter would have been willing to shoulder Westside's offering if the weight of the task included trying to explain away Fryar's suspicious land transactions and the Booz, Allen study.

The bondholders claim that this testimony proves that, like the securities in Shores, the Westside bonds were brought to market only through fraud, and were not entitled to be marketed at all. The defendants respond that only worthless securities are not entitled to be marketed under Shores. They argue that if the bonds retained any value at all, the plaintiffs have shown

"no more than that the bonds would have been offered at a lower price or a higher rate...." Shores, 647 F.2d at 470. According to the defendants, the plaintiffs' theory is only that they bought inferior bonds, not as Shores requires, that they bought bonds fraudulently brought to market. Id. at 471.

The bondholders argue that worthlessness is not a prerequisite, under Shores, for establishing a fraud on the market. The bondholders correctly note that the Shores plaintiffs recouped about 37 percent of their investment when the municipal assets dedicated to the failed corporation were liquidated. They conclude that the Shores stocks were not worthless and that worthlessness, therefore, cannot be the touchstone of a

fraud-on-the-market analysis.

This argument misses the point, since saleable assets may bless even the most worthless enterprise. In Shores, the illegitimate securities represented an investment in a hoax made to seem real because valuable assets, including a factory, backed the promoters' promises. Although the assets may have added value to the securities, the sham "business" did not because the promoters never intended to start a legitimate one.

We hold, therefore, that securities meet the test of "not entitled to be marketed" only where the promoters knew the enterprise itself was patently worthless. We add that expert testimony, however well-founded in the experience of securities traders, is nothing more than the speculation of observers benefiting

from hindsight. All of the careful analysis of securities pundits and expert calculations of experienced investors cannot replace the irrefutable knowledge gained from a single source: the actual track record of the security itself.

Shores established a test more sensitive to the historic value of the subject securities than the bondholders acknowledge. As we said in Shores, a securities fraud plaintiff must argue not "that he bought bonds, but that the bonds he bought were fraudulently marketed." Id. at 471. Finkel succinctly characterized this test:

> The majority in Shores simply recognized that a Rule 10b-5 action based on the fraud on the market theory could embrace a claim for fraud that resulted in the issuance of worthless securities as well as a fraud that inflated the price of a security.

817 F.2d at 364 (footnote omitted).

Here, the bondholders' argument fails because the Westside bonds always had a legitimate value in the bond market. Indeed, these bonds remained near market value for several years after Westside disclosed the accurate version of its beginning and several months after this lawsuit commenced.

Moreover, we perceive strong policy reasons to reject the bondholders' contentions. The plaintiffs' position would attenuate the fraud-on-the-market presumption of reliance far beyond its proper bounds and almost entirely extinguish reliance as a legitimate element of a rule 10b-5 claim. This presumption assumes that investors ordinarily and correctly rely upon the "market price" of a security as an accurate estimate of the future value of

that security. Accordingly, if a defendant distorts the market price by lying or concealing the truth, the fraudulently distorted price can deceive even prudent investors.

This theory, however, implicitly assumes that there is an active, efficient secondary market capable of accurately measuring the present and future value of a security. Moreover, the theory supposes that most investors seek out securities whose prices the market accurately reflects.

Where, as here, investors seek out underpriced securities that are traded outside efficient secondary markets, the fraud-on-the-market theory of reliance no longer makes sense. Investors can no longer be said to have relied upon an established market price, which, if it

exists at all, reflects an inherently unstable and probably inaccurate estimate of the security's actual value. Moreover, Abell has never argued - indeed, the evidence belies such an argument - that Westside bonds ever lacked any value. Given the inherently imprecise means available to measure the actual value of Westside bonds at any given point in time, Abell's argument that the members of the plaintiff class presumably relied upon the market price for those bonds is unconvincing.

Consequently, we reject bondholders' arguments and hold that the fraud-on-the-market presumption of reliance is available only (1) where the subject securities were traded actively in large markets, or (2) where the promoters knew that the subject enterprise was worthless

when the securities were issued, and successfully issued the securities only because of defendants' fraudulent scheme. Since the Westside bonds fail to meet either test, and since the Ute presumption is here unavailable, plaintiffs have failed to establish reliance for the class, and the class's rule 10b-5 claim must fail.

2. Reliance of Some Individual Members of the Class

Two of the individual plaintiffs, Abell and Walton, testified that they did in fact rely upon the defendants' misrepresentations. Walton testified that he considered the attractive interest rate which the bonds bore, a Swink flyer that had not been authorized by WLJ and the advice of Dick Hardwick, a Swink broker. Abell testified that he

relied upon the attractive interest rate, Hardwick's reputation as a broker, the fact that Westside bonds were Louisiana municipal bonds, and Fryar's promise to invest $2,000,000 of his own case in Westside. We conclude that this testimony, which was uncontradicted at trial, is enough to establish that Abell and Walton relied upon Fryar's misrepresentations. We do not, however, think that it is sufficient to prove that Abell and Walton relied upon anything which WLJ said or did.

WLJ never had any direct contract with Westside's bondholders. Consequently, the bondholders may not assert that WLJ misrepresented or failed to disclose any material facts directly to the bondholders. Instead, WLJ limited its role in the Westside bond-offering to

the legal work it did for the bond underwriters. Consequently, WLJ never made any statements on its own behalf directly to the bondholders, but only checked and revised the statements made in the offering statement.

Neither Abell nor Walton testified that he relied upon that statement. Instead, their own testimony indicates that they relied only upon the attractiveness of the offer, Fryar's misrepresentation as to his own investment in Westside, and Swink's misguided (or fraudulent) assessment of the bonds' value. Neither Swink, which knew more about the bonds than it cared to reveal in the offering statement, nor Abell and Walton, who did not seem to care what the offering statement actually said, can be said to have relied upon the

offering statement itself.

Consequently, none of the plaintiffs has proved that he relied upon WLJ's legal opinion, however good or bad that opinion may have been. From our foregoing analysis, we conclude that Abell and Walton have shown that Fryar and the underwriters, but no WLJ, have violated rule 10b-5 and are liable to Abell and Walton for damages.

Thus, Abell and Walton (but not the class) have shown that Fryar misrepresented material facts, that they relied upon these misrepresentations in choosing to buy Westside bonds, and that Westside's actual financial structure eventually caused Abell's and Walton's losses. Abell and Walton did not prove, however, that anyone ever relied upon anything WLJ did, said, or wrote. Thus,

they have not proven that WLJ violated rule 10b-5 directly. Our analysis, however, does not suggest that WLJ is not vicariously liable for the role of the underwriters played in executing Fryar's fraud.[17] We next analyze that theory.

D. WLJ's Potential Vicarious Liability

The bondholders suggest that, under two separate theories, WLJ is vicariously liable for Fryar's and the underwriters' fraud. The plaintiffs assert first that WLJ had a special duty, as underwriters' counsel, to the investing public to ferret out and disclose publicly any fraud. Second, according to the bondholders, WLJ rendered substantial

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[17] WLJ does not argue that, at most, only Fryar committed fraud. Since WLJ does not challenge the jury's finding that the underwriters participated in the fraud, we accept the jury's verdict.

assistance to the fraudulent scheme despite the unmistakable sings that fraud was afoot. By turning a blind eye to these signs, the bondholders argue, WLJ subjected itself to rule 10b-5 liability for aiding and abetting securities fraud. We examine each of these arguments in turn.

1. Duty to Disclose

The bondholders argue that WLJ implicitly guaranteed the accuracy of the offering statement to the investing public. According to the bondholders, WLJ impliedly assumed a duty to correct all material misrepresentations in the offering statement when it agreed to assume the responsibilities of an underwriter's counsel. Thus, the bondholders conclude, WLJ issued deficient legal opinions, subjecting it

to liability, because it failed to discovery and disclose Fryar's fraud.

The bondholders derived this proposition of law from four well-established practices of the securities bar. First, underwriter's counsel, acting on behalf of the underwriter, traditionally prepares the offering statement. Second, underwriter's counsel assumes a due-diligence duty to ensure that the offering statement is correct in all material respects. Third, this due-diligence duty derives from the fraud provisions of the securities laws, which themselves exist primarily to protect innocent investors. Fourth, Westside's offering statement listed WLJ as underwriter's counsel - a fact that suggests to the plaintiffs that WLJ implicitly took public responsibility for

the legal sufficiency of the offering statement itself.

We cannot agree with the bondholders' argument. Traditionally, lawyers are accountable only to their clients for the sufficiency of their legal opinion. It is well understood in the legal community that any significant increase in attorney liability to third parties could have a dramatic effect upon our entire system of legal ethics.[18]. An

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[18] See, e.g., First Mun. Leasing Corp. v. Blankenship, Postts, Aikman, Haigin & Stewart, 648 S.W.2d 410, 413 (Tex. App, 5 Dist. 1983, writ ref'd n.r.e) (refusing to extend attorney malpractice claims to third parties not in privity with the defendant lawyer); Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490, 497 (7th Cir. 1986) ("[L]awyers ... are [not] required to tattle on their clients in the absence of some duty to disclose. To the contrary, attorneys have privileges not to disclose"

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attorney required by law to disclose "material facts" to third parties might thus breach his or her duty, required by good ethical standards, to keep attorney-client confidences. Similarly, an attorney required to declare publicly his or her legal opinion of a client's actions and statements may find it impossible to remain as loyal to the client as legal ethics properly require.[19]

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(citations omitted).); Goodman v. Kennedy, 18 Ca.3d 335, 134 Cal.Rptr. 375, 556 P2d 737, 743 (Cal. 1976) (if attorneys were liable to both clients and other parties to arms-length transactions, attorneys would become self-protective and could not fulfill counseling role).

[19] See Barker; Page v. Frazier, 388 Mass. 55, 445 N.E.2d 148, 153 (1983) (absent separate attorney-client relationship, lawyer owes no duty of reasonable care to adverse party

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Cognizant of these risks, the law, as a general rule, only rarely allows third parties to maintain a cause of action against lawyers for the insufficiency of their legal opinions. In general, the law recognizes such suits only if the non-client plaintiff can prove that the attorney prepared specific legal documents that represent explicitly the legal opinion of the attorney preparing them, for the benefit of the plaintiff.[20] Goodman, 556 P.2d at 743; Bush, 519 F.Supp. at 596.

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because of attorney's conflicting duty to client); Bush v. Rewald, 619 F.Supp. 585 (D.Haw.1985) (lawyer owed no duty to investors buying from organization where organization, not investors, was attorney's client).

[20] This rule, which a growing number of states have adopted for imposing

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In practice, this rule has meant that an attorney is rarely liable to any third party for his or her legal work unless the attorney has prepared a signed "opinion" letter designed for the use of a third party. Compare S.E.C. v. Spectrum, Ltd., 489 F.2d 535 (2d Cir. 1973) (plaintiff may state rule 10b-5

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liability for negligently-rendered opinions, reflects the increasing influence of Restatement (Second) of Torts §552 (1977). That section provides:

Information Negligently Supplied for the Guidance of Others

(1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable

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action against attorney who signed an opinion letter another had declined to sign) with Keene Corp v. Weber, 394 F.Supp. 787 (S.D.N.Y. 1975) (attorney not liable under rule 10b-5 because no misleading opinion letter at issue).

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care or competence in obtaining or communicating the information.
(2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered

(a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and

(b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

(3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.

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The bondholder plaintiffs argue that other courts have established less restrictive tests to determine whether securities lawyers are liable to those who invest in securities the lawyers' clients have issued or underwritten. The three most relevant are Spectrum; Cronin v. Midwestern Dev. Auth., 619 F.2d 856, 862 (10th Cir. 1980); and In re Flight

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(Continued from previous page) Section 552, however, has not affected legal malpractice law as much as that provision has impacted other areas of malpractice law. A majority of states still require privity between legal malpractice plaintiffs and defendants. See generally Annotation, What Constitutes Negligence Sufficient to Render Attorney Liable to Person Other than Immediate Client, 61 A.L.R. 4th 464 (1988); Annotation, Attorney's Liability, to One Other than Immediate Client, for Negligence in Connection with Legal Duties, 61, A.L.R. 4th 615 (1988). See also First Mun. Leasing Corp, 648 S.W.2d at 413.

Transp. Corp. Sec. Litig., 593 F.Supp. 612, 617-18 (D.Minn 1984).

In Spectrum, however, the Second Circuit held a lawyer liable under rule 10b-5 because he signed a critical opinion letter which another lawyer, who escaped liability, had refused to sign. Accrod, Keene Corp. (describing the holding of Spectrum). In Cronin, the Tenth Circuit suggested that courts could impose rule 10b-5 liability upon bond counsel, who ordinarily does issue an opinion letter that comes attached to the offering statement or prospectus.

Of the three cases, only Flight Transp. Corp. squarely departs from the traditional rule to impose rule 10b-5 liability upon all underwriter's counsel. Flight Trans. Corp. however, has no precedential value here, and we find its

reasoning unconvincing.[21] Since we can find no binding authority creating a special rule in the field of securities law, [22] we decline to depart from either rule or practice here.

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[21] The bondholders cite numerous other cases to support their position, but most are easily distinguishable. Several impose liability upon lawyers who issued opinion letters. E.G., Morgan v. Prudential Group, Inc., 527 F.Supp. 957 (S.D.N.Y. 1981), aff'd, 729 F.2d 1443 (2d Cir. 1983). Others involved lawyers who stepped out of their professional legal roles and actively promoted the securities (e.g., S.E.C. v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1095 (2d Cir. 1972)), or attorneys who were sued by their own clients (e.g., DCD Programs Ltd. v. Leighton, 833 F.2d 183, 190 (9th Cir. 1987)). The remaining cases are district court cases with little precedential weight here.

[22] We have failed also to find any authority requiring us to follow the general rule here. WLJ cites us to Dirks v. S.E.C., 463 U.S. 646, 103 S.Ct. 3255, 77 L.Ed.2d 911 (1983), and Chiarella v. United States, 445

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Plaintiffs presented almost no evidence that WLJ's due diligence duties existed to benefit or protect the investing public at large. Rather, bondholders provided only that WLJ had a duty to its clients to ensure that they complied with securities laws. The mere fact that these laws were designed to

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(Continued from previous page) U.S. 222, 100 S.Ct. 1108, 63 L.Ed.2d 348 (1980), but we find these cases inapposite here. Both Chiarella and Dirks analyzed cases in which the S.E.C. charged the defendants with having breached a specialized, pre-existing duty to disclose certain facts. In these cases, the S.E.C.'s claims rested upon whether the defendants had a duty to speak when they preferred to remain completely silent. Here, by contrast, the plaintiffs have alleged that WLJ, by its actions, adopted the false statements and distortions made by its clients. The claimed duty here, then is not a duty to speak rather than remain silent, but a duty to correct false statements and distortions rather than acquiesce in them.

protect the investing public does not convince us that WLJ assumed more than the duty to protect its own clients from legal liability. "The securities laws do not impose liability for ordinary malpractice, even though that malpractice may diminish the value of the issuer and thus of the issuer's securities." Barker, 797 F.2d at 496.

Nor do we believe that WLJ assumed any duties to these bondholders merely by allowing its name to be included in the final offering statement. We think it more significant that WLJ never signed the offering statement itself or any of the documents included in that statement. Moreover, the offering statement says only that WLJ passed on legal issued for the underwriters, its clients. By contrast, the offering statement does not

limit for whom the bond counsel had prepared his opinion. If any of the attorneys or law firms assumed legal responsibility for the sufficient of the offering statement, it was bond counsel William Skye, who actually did sign a letter disclosing his own legal opinion regarding several aspects of the bond offering.

We join the Seventh Circuit, which, in Barker, id. at 497, commented:

> We express no opinion on whether the [attorneys] did what they should [or] whether there was malpractice under state law.... We are satisfied, however, that an award of damages under the securities laws is not the way to blaze the trail toward improved ethical standards in the legal and accounting professions. Liability depends on an existing duty to disclose.... The plaintiffs have not pointed to any rule imposing on [attorneys] a duty to blow the whistle. [Emphasis in original.]

Accordingly, WLJ owed no duty of

disclosure to the bondholders.

2. Aiding and Abetting

Finally, the bondholders argue that even if WLJ did not itself commit securities fraud, it nonetheless aided and abetted Fryar and Swink in their scheme to commit securities fraud. As the plaintiffs correctly note, our cases impose section 10b-5 liability upon those who are securities fraud. Woodward v. Metro bank, 522 F.2d 84 (5th Cir. 1975).

We have recently restated the Woodward test to determine who is subject to section 10b-5 aiding-and-abetting liability: (1) There must have been a securities violation by the primary party; (2) the aider and abettor must have had a "general awareness" of its role in a rule 10b-5 violation; and (3) the aider and abettor must have knowingly

rendered "substantial assistance" in the rule 10b-5 violation. Bane v. Sigmundr Exploration Corp., 848 F.2d 579, 581 (5th Cir. 1988).

We have already held that substantial evidence supports the jury verdict that Fryar and the underwriters committed securities fraud. Moreover, WLJ does not challenge the bondholders' implicit assertion that it substantially assisted the underwriters in effecting their scheme. Thus, it remains only to determine whether WLJ was "generally aware" of its role in furthering the fraudulent scheme, and whether its assistance was "knowing."

In Woodward, we explained what these scienter requirements mean. "General awareness", we said, means knowledge which, though it may be adduced from

reckless conduct, means actual awareness. 522 F.2d at 96. We also held that how "knowing" an abettor must be depends upon how substantial the abettor's assistance is:

> When it is impossible to find any duty of disclosure, an alleged aider-abettor should be found liable only if scienter of the high 'conscious intent' variety can be proved. Where some special duty of disclosure exists, then liability should be possible with a lesser degree of scienter.... In a case combining silence/inaction with affirmative assistance, the degree of knowledge required should depend on how ordinary the assisting activity is in the business involved. If the evidence shows no more than transactions constituting the daily grist of the mill, we would be loathe to find 10b-5 liability without clear proof of intent to violate the securities law. Conversely, if the method or transaction is atypical or lacks business justification, it may be possible to infer the knowledge necessary for aiding and abetting liability. In any case, the assistance must be substantial before liability can be imposed under 10b-5.

Id. at 97 (citations and footnotes omitted).

Woodward appears to divide scienter into two parts: knowledge of one's role in a fraud, and commitment (or intent) to aid in the fraud's success. Scienter, then, would require first that the alleged abettor know of the fraud's existence and generally understand how its actions aid in promoting the success of the fraud. The second element of scienter - commitment - would be met where evidence shows that the abettor acts from a desire to help the fraud succeed.

> Naturally, whether the plaintiff needs evidence independent of the abettor's actions to prove commitment depends upon the nature of the defendant - abettor's assistance. Silent acquiescence never indicates by itself that the abettor wants the fraudulent scheme to succeed; here, we usually require proof of "conscious intent." Id.

Even when an abettor takes positive actions that aid a nefarious plan, the abettor does not always approve of the scheme's success. Thus, "we would be loathe to find 10b-5 liability without clear proof of intent to violate the securities laws" where the assistance amounts to "no more than transactions constituting the daily grist of the mill...." Id. On the other hand, those who go out of their way to aid a fraud are generally the most willing and committed to its success.

If this view of Woodward is correct, then it would harmonize the law of rule 10b-5 aiding an abetting with its roots

in the criminal law.[23] However, both the commentators and our sister circuits view the scienter requirement as a single rule that determines both one's level of awareness and "knowing and substantial assistance" according to the same rule. See e.g., IIt, an Int'l Inv. Trust v. Cornfeld, 519 F.2d 909, 923 (2d Cir. 1980) (Friendly, J.) Under this generally-accepted view, Woodward

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[23] The federal criminal aiding and abetting statute requires that the alleged abettor share in the criminal intent of the principal and engage in affirmative conduct designed to aid the venture. United States v. Ortiz-Loya, 777 F.2d 973,

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establishes a single test for scienter that varies as the level of assistance decreases on a sliding scale from recklessness to "conscious intent." Under either rule, however, we

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(Continued from previous page) 980 (5th Cir. 1985). Accord, United States v. Weddell, 800 F.2d 1404, 1408 (5th Cir.), modified, 804 F.2d 1343 (5th Cir. 1986). "Thus, to sustain a conviction, the evidence and reasonable inference therefrom must show [the defendant] knew that a fraud was occurring, that he associated himself with that fraud, that he participated in it with a desire that it be accomplished, and that he committed some overt act designed to make it a success." United States v. Westbo, 746 F.2d 1022, 1025 (5th Cir. 1984).

must determine whether the alchemy of WJL's level of assistance, combined with its level of knowledge of the unfolding fraud, supports a jury verdict against WLJ. Here, we think it does not.

We review the evidence, as we must, in the light most favorable to the plaintiff bondholders. They established that WLJ knew that one of its clients (Hancock) was under SEC investigation for securities violations. The evidence also permitted the jury to conclude that WLJ knew that the FBI, the SEC, and the National Association of Securities Dealers were also investigating Hancock. Additionally, WLJ was aware that both the original underwriter's counsel and the original bond counsel had resigned from their representations - a further sign that something might be amiss.

Nonetheless, WLJ did little to investigate what its client had done previously or why the original counsel had resigned. Moreover, WLJ readily made several material changes to the final offering statement without asking its clients (who requested the changes) why they should be made. Finally (and again), according to the evidence most favorable to plaintiffs), WLJ failed to investigate properly the truth of the offering statement despite its duty to its clients to do so.[24]

We conclude that this evidence is not strong enough to sustain the jury's verdict as to WLJ. First, in examining what WLJ did to assist in the fraud, we

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[24]. We re-emphasize that WLJ's duty ran to its clients, not to the bondholders.

determine that WLJ provided only legal services that "[constitute] the daily grist of the mill" of a law firm with a substantial securities practice, Woodward, 522 F.2d at 97. Consequently, Woodward requires "clear proof of intent to violate the securities laws." Id. But at best, the evidence shows only that WLJ recklessly disregarded its duties to its clients. WLJ ignored several warning signs that the jury could have found aroused the law firm to suspect the propriety of the offering.

Aroused suspicions, however, do not constitute actual awareness of one's role in a fraudulent scheme. Moreover, to prove plainly that an alleged abettor intended to violate the securities laws, plaintiffs must prove more than that the abettor recklessly ignored danger

signals.[25] Consequently, we conclude that the jury's verdict holding WLJ liable for securities fraud was not supported by the evidence, and we overturn that verdict.

IV. RICO

The bond holders also claim that Fryar and All American violated the provisions of the Racketeering Influenced and Corrupt Organizations Act ("RICO").[26]

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25. We note that this analysis is the same whether we characterize "clear proof of intent" as the proof necessary to establish commitment.

26. 18 U.S.C. §§ 1961-1968. The portions of RICO that are relevant to this appeal are:

§ 1961. Definitions
As used in [RICO]-
(1) "racketeering activity" means...
(B) any act which is indictable under any of the following provisions of title 18, United States Code:...
section 1341 (relating to mail fraud),
section 1343 (relating to wire

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Specifically, they repeated the allegation that Fryar committed securities fraud and also charged these defendants with mail fraud and wire fraud. The jury believed the bondholders

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fraud),... or (D) any offense involving...fraud in the sale of securities....

(5) "pattern of racketeering activity" requires at least two acts of racketeering activity, one of which occurred after the effective date of this chapter and the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity.

§ 1962. Prohibited activities
(a) It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt in which such person has participated as a principal within the meaning of section 2 title 18, United States Code, to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in

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and found that Fryar's racketeering activity had caused $850,000 damage to the bondholders. The trial judge, who apparently assumed that these damages did

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acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce. A purchase of securities on the open market for purposes of investment, and without the intention of controlling or participating in the control of the issuer, or of assisting another to do so, shall not be unlawful under this subsection if the securities of the issuer held by the purchaser, the members of his immediate family, and his or their accomplices in any pattern or racketeering activity or the collection of an unlawful debt after such purchase to do amount in the aggregate to one percent of the outstanding securities of any one class, and do not confer, either in law or in fact, the power to elect one or more directors of the issuer.

(b) It shall be unlawful for any person through a patter of racketeering activity or through collection of an unlawful debt to acquire or maintain directly or

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not duplicate the securities damages, any enterprise which is engaged in, or trebled the jury's figure and awarded the plaintiffs $2,550,000 on their RICO

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indirectly, any interest in or control of the activities of which affect, interstate or foreign commerce.

(c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

(d) It shall be unlawful for any person to conspire to violate any of the provisions of subsections (a), (b), or (c) of this section.

§ 1964. Civil remedies...
(c) Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the

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claims.[27] Fryar attacks this judgment on three grounds.

First, Fryar asserts that plaintiffs failed to prove any compensable damages. Title 18 U.S.C. § 1964(c) authorizes "[a]ny person injured in his business or property" to sue based upon the injurious RICO violations. Fryar argues that the evidence did not establish (1) any injury to plaintiffs' business or property or (2) any causal connection between the plaintiffs' putative injuries and Fryar's misrepresentations.

We disagree. Plaintiffs proved, to the jury's satisfaction, that the

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(Continued from previous page) damages he sustains and the cost of the suit, including a reasonable attorney's fee.

27. The court was required under 18 U.S.C. § 1964(c) to treble the bondholders' damages. See supra n. 26.